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POPULAR BOOK DEPOT,
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Introduction

IN a world of tensions and uncertainties that collectivist ideologies like Fascism, Communism and Socialism have created, the dictum that knowledge is power is obviously overemphasised. In order to gain control of the machinery of the State, for sake of the coercive powers it entails, there is a premium on that type of knowledge which gives access to political power. The other attribute of knowledge, viz., that it also means freedom, has been overlooked. But it is this attribute of knowledge which has greater relevance to the Indian context today.

With increasing industrialisation of the country, our social structure as well as economic life are undergoing rapid changes. In the economic sphere, specialisation and division of labour as also diversification call for changed attitudes towards work and acquisition of specialised skills. Possession of the knowledge of the changing scene will impart to individuals a sense of self-reliance, a quality so essential for the operation of a democracy. Patience and massive public education are required to spread knowledge of the changing economic scene.

With a view to helping people to gain a better understanding of the nature of modern enterprise, the Forum

of Free Enterprise had organised a series of lectures on this subject, true to its educative role in national affairs. Popular Book Depot have been good enough to present to the public the text of these lectures in the form of a pocket book. They are to be complimented.

Incidentally, the organising of this series of lectures, and the subsequent presentation of the text of lectures underlines the latest trend in the public life of the country. People have started realising that it is they themselves that can help to create a free and prosperous nation, and not the Leviathan of the State. May this trend gather momentum in years to come.

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Contents

1

How to Start an Industry

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"HOW to start an industry" is a vast and complicated subject, for it covers not only large, medium and small industries, but also the various Governmental agencies which have been started to help their development. I shall first give an idea of the various types of industries, and then deal with the procedure to be followed to establish any industry.

There are various departments in the Government sanctioning schemes for starting an industry. The Government recognises only two types of industries, large and small, apart from other specialised industries like the village industries under the Khadi and Village Industries Commission, and industries falling under the purview of the Handicrafts Board, Silk Board, Coir Board and Handloom Board. Medium

industries, which have lately developed, are classified by the Government as large industries. The definition of a small industry is the demarcating factor.

The Government seriously started planning for the development of small industries in 1953-54. They were then mainly those industries which were not registered with the Development Wing of the Government of India. The Government had no classification either. There was no department as such of the Government which was specially established to help industries which were not registered.

So, any industry which did not come under the Industries (Development and Regulation) Act of 1951—that is under the Development Wing—was a small industry. Thus any industry with less than 50 workers and working with power, or less than 100 workers without power, and with assets of less than Rs. five lakhs came to be considered a small industry.

The Government considered various schemes and established the organisation of the Development Commissioner, Small-Scale Industries, to assist intensive development of small industries. The impact of the scheme of development was soon felt and the small industrialists and the Government soon realised that the existing definition was not adequate.

The definition was later changed to less than 50 workers per shift with power or less than 100 workers per shift without power, and Rs. five lakhs or less of capital assets. The argument was put up that limiting the number of workers in a small scale industry re-

sulted in limiting the number of shifts and consequently reduced the production that could be reached with the same amount of capital outlay.

The definition was again changed in 1958. Now, any industry is a small industry which has a block capital of Rs. five lakhs or less irrespective of the number of workers employed. Block capital is defined as the cost of land, building and machinery.

The enlargement of the definition is a great achievement by itself and shows the earnestness of the Government to help the small industries. The earlier definition denied this help to many industries on the borderline.

In 1951, the Industries (Development and Regulation) Act was enacted in order to develop large-scale industries. This Act intends to ensure that there is a planned development of industries throughout the country, with no concentration of any particular type of industry in any one region. Also the Government wanted the power to regulate the development of industries and the basic structure of the country's growing economy.

The industries that came under this Act were registered with the Development Wing of the Ministry of Commerce and Industry for assistance and regulation. The Development Wing consists of many specialised departments. There are about 17 Technical Directors, 3 Industrial Advisers and about 85 Development Officers. The main functions of the Wing

are to approve the scheme, to issue recommendations for licences for raw materials and capital goods, to sanction increased production, diversification of products, improvement of the quality of products and scrutinising collaboration agreements, steel quotas, cement, promotion of exports, etc.

Till recently, previous sanction of the Development Wing was necessary for starting an industry which will employ 50 or more workers with power or 100 or more workers without power and have more than Rs. five lakhs capital assets. Now the rules have been relaxed and industries with less than Rs. 10 lakhs capital or employing less than 100 workers can start on their own. But that does not make them small industries because the definition of a small industry applies only when the capital assets are Rs. five lakhs or less.

Industries with capital assets exceeding Rs. five lakhs but less than Rs. 10 lakhs and employing less than 100 workers are intermediary industries. Their development has been facilitated because they do not come under the orbit of the Development Wing for sanction.

It generally takes more than five months on an average for getting such a sanction. The law stipulates that an application should be processed within three months, but an excuse can always be provided for any delay in the processing by asking a few simple questions. Sometimes it has taken 15 months for getting a sanction. The Rs. 10-lakh limit laid down provided

better chances for basic industries to come without any prior sanction.

The Development Wing helps even these industries in getting import licences for machinery or raw materials. Thus, in effect, it is only when the machinery is of Indian origin and when the raw materials are available locally that an industry can be started without any prior Government sanction.

Any industry registered with the Development Wing can expand its capacity with the sanction of the Development Wing. When this additional capacity is sanctioned, it also means that the Development Wing is bound to give raw material licences or recommend the issue of such licences to the Chief Controller of Imports and Exports. The further raw material quotas are not very hard to get provided the permission of the Development Wing is taken. This is not the case with a small industry.

Before starting a large industry a scheme has to be prepared which should mention particulars relating to the requirements of block capital, list of machinery to be imported or procured from indigenous sources, estimates of recurring and non-recurring expenditure, the cost of production, the profit that is expected to be made, requirement of foreign technicians, proposed location, power requirement, requirement of raw material, water supply, requirement of rail transport, etc. If foreign collaboration is involved, the procedures are still more elaborate.

There are special forms for obtaining the sanction

of the Development Wing. Seven copies of the application have to be sent to the Secretary, Ministry of Commerce and Industry, who sends these forms to various Departments, to the Development Wing—Directorate of that particular industry for scrutiny and to the State Director of Industries to find out whether the information given by the applicant regarding power supply, location and the essentiality is correct or not. After this preliminary investigation, the application is placed before the Licensing Committee. This investigation takes time and if the application forms are not correctly filled in, the sanction will be delayed. Normally, the sanction can be got within three months.

It is also necessary to apply and take consent of the Controller of Capital Issues in the Ministry of Finance, for raising any capital of more than Rs. 10 lakhs in the capital market.

If the project involves foreign collaboration, the terms of such collaboration have to meet the approval of the Government. The terms sanctioned depend on the merits of each case. The basic requirements of the Government are :

1. The scheme should not involve recurring commitments for royalty payments for a period extending beyond 10 years.

2. There should not be any restriction by foreign collaborators on exports of the products manufactured in our country. There should not be a total restriction. We should be

allowed to sell the products at least to some countries.

3. There should not be compulsion to purchase components from the foreign country concerned.
4. Royalties should be related to the turnover and not laid down on an **ad hoc** basis.
5. The scheme should have effective Indian control.
6. There should also be a clause for training Indian personnel in factories in foreign countries.

Following these principles would normally ensure Government's approval of collaboration terms. The Government on its part also gives a number of concessions. They are :

1. It allows appropriate interest on the loan of the foreign collaborators.
2. It guarantees to protect the foreign investment.
3. It gives tax concessions and will consider the repatriation of capital if it is spread over a number of years.

Application for sanctioning the terms of the collaboration were formerly to be made to the Exchange Control Department of the Reserve Bank of India. But now the work has been centralised and applications should be made to the Government of India, Commerce and Industry Ministry, Industrial Policy Section, New Delhi.

The import licence is granted after the terms of foreign collaboration are approved. The Government is very choosy where substantial amounts of foreign exchange are required for import of machinery. The application should specify the country of origin and the currency area. Alternate preference should always be given, unless it is necessary to obtain machinery only from a particular country. For example when the Development Loan Fund sanctions loans, machinery has to be imported from the U.S.A. only. Otherwise preference is generally given to the country which has easy repayment agreements with the Government of India.

Arrangements for long-term loans for purchase of capital equipment are to be made with organisations like the Industrial Refinance Corporation of India, the Industrial Credit and Investment Corporation of India, and the International Finance Corporation, U.S.A. If the foreign collaborators agree to supply the machinery themselves, then the application is sure to be passed by the Government after scrutinising the terms of participation.

To obtain final sanction, the application with complete data is placed before the Licensing Committee consisting of representatives of various Ministries, viz., Commerce and Industry, Finance, Labour, Mines and Fuel, Steel and the Planning Commission, for scrutiny from a number of angles.

For example, the location of an industry is of vital importance. Alternative location may have to be

agreed to. After getting all these documents, viz., sanction from the Development Wing, Import Licences from the Chief Controller of Imports, sanction of the Controller of Capital Issues for capital issues, approval of foreign collaboration agreement, one is well set for starting a new large industry.

The small industries are not in such a happy position as large-scale industries are, as far as Governmental help is concerned. There is no department of the Government to help them to get raw materials, except the Director of Industries of the State, whose help has proved ineffective. The small-scale industries may get licence for raw materials once and may not get it the next time. Due to this reason, a small industry is not as easy to start as one may imagine.

The fillip to the setting up of small industries was given in 1953 when the Ford Foundation observed that small industries had been left to themselves. No engineers or technical personnel were employed by small industries, for they could not afford them. Large industries did not buy stores from small industries because they could not trust the quality. The Ford Foundation team suggested a number of remedies. They suggested that the Government should start a pool of technical people who would be located at different places all over the country to help these small industries in technical matters.

They also suggested that the Government should help these industries in obtaining machinery on a hire-purchase, easy instalment basis. For this purpose,

they suggested that a Corporation should be established by the Government which could also look after marketing research and other promotional activities connected with the products of small-scale industries. The Government being a bulk purchaser of commodities, the Ford Foundation suggested that it should help small industries by purchasing their products.

The Government set up the Small Industries Service Institute in 1955 at Bombay, Madras, Delhi and Calcutta, with mechanical, electrical, chemical, rubber and plastics, leather, foundry, civil engineering and survey sections and for training persons in business management. The duties of these institutes are more or less advisory. The number of these Institutes has been increased gradually and now each State in India has an Institute and there are also some Branch Institutes and 45 Industrial Extension Centres.

The Institutes give technical advice regarding improvement of production techniques, marketing and management problems. Over 3,000 schemes have been prepared by the 16 Institutes so far. The Institutes also help in obtaining machinery on hire-purchase basis and credit for purchase of raw materials.

The Training Section of the Institute not only trains the Small Industrialists in Business and Industrial Management, but also trains Industries Officers from the States, who will be in charge of industrial departments in the National Extension Service Blocks, the network of which covers the whole country.

This idea, borrowed from the United States, has been implemented during the Second Plan. A trained Officer is allotted to a Block of 100 villages to advise and guide the people in village and small-scale industries. Likewise, specially trained Officers for advice in agriculture, health, animal husbandry, social welfare, etc., are also posted to the Block. The Institutes train the Block Level Extension Officers (Industries) for these Blocks. The Training Section also conducts evening classes in blueprint reading, heat treatment of metals, electroplating, scientific glassware manufacture, etc., for small industrialists who can gather knowledge during their spare time.

The Institute extends technical help to villages with the assistance of mobile workshops. There are mobile workshops for carpentry, blacksmithy, electroplating, leather, etc. With each Institute, there are four or five such workshops which tour all over the country. They actually give demonstrations of work to show to the villagers the application of the machine to the craft and the increased output resulting from the use of machines. These units supply hire-purchase forms which are easily processed. The mobile workshops carry into the remote villages ideas of the most modern equipment and have been a great success.

Industrial Extension Centres are designed to give training as well as to provide facilities for use of machines to small industrialists who cannot afford to buy costly machines. There are 55 Extension Centres mostly located in urban areas with specialized machi-

nery, not only giving training and facilities for the use of such machines to small industrialists but also acting as information centres in the area for new-comers in the field. Thus, there are Industrial Extension Centres in towns; Mobile workshops for the villages, and the Service Institute for the cities.

The Institutes design factory buildings, etc., for the Industrial Estate schemes prepared by State Governments. They conduct various types of surveys, such as industrial area and aid distribution surveys. An industrial survey gives data relating to any particular industry in India and an idea of the scope for future development. Area surveys are conducted to determine what industry can be started in any particular area, and the distribution aid surveys help individual industries in locating the markets of their products. The Institutes also publish technical bulletins, reports and schemes.

Apart from the Institutes, there is one more organisation, with branches at Bombay, Delhi, Calcutta and Madras, which helps small-scale industries. The National Small Industries Corporation was established in 1955 for providing help such as supply of machinery on hire-purchase basis, obtaining Government tenders for small industries' products and rendering marketing assistance through intensive market publicity, quality marking and export.

Between June 1956 and March 1961 the Corporation has accepted applications for hire-purchase from 4,549 applicants for 17,829 machines, costing more

than Rs. 18 crores. Of these, it has delivered 4,633 machines costing approximately Rs. 3.23 crores, and is delivering machines costing Rs. 10 lakhs or more every month. There have been some delays and difficulties because of rigorous import licensing procedures.

Hire-purchase machines are given on liberal terms. For example, for machinery valued up to Rs. 50,000 the earnest money which is in fact the first yearly instalment, is 10 per cent; and for machines valued above Rs. 50,000 it is 20 per cent. The balance is to be paid in seven years' time in equal half-yearly instalments at six per cent interest. This has been further liberalised and a small-scale industrialist can now pay up to five per cent as earnest money on acceptance of the application and give a bank guarantee for the remaining five per cent or 15 per cent as the case may be, to be paid at the time of delivery. Further concessions are given for industrial co-operatives and ancillary industries which manufacture components for large industries in the public and private sectors.

In the field of marketing, the Corporation has helped the small industries in intensive selling campaigns through mobile sales van, quality marking under the "JANSEVAK" brand, and exporting of their products, mainly to East European countries. Shoes manufactured by small industries, under the guidance of the Corporation, have been successfully exported to Russia, Poland, the German Democratic Republic,

Bulgaria, etc. Nearly eight lakhs of pairs have been exported and it speaks for the quality of the shoes that there were repeat orders from these countries.

The Corporation helps small industries in manufacturing quality products and selling them to large public and private sector industries as well as to Government purchasing departments such as the Director-General of Supplies and Disposal, Railways, Defence Services, etc. It registers the small industries capable of producing quality products, free of charge and supplies them free tenders, while the Liaison Officers of the Corporation, attached to the purchasing authorities, see that the small-scale industries get a fair deal and get the price preference (maximum of 15 per cent) over the lowest acceptable quotations of the large industries.

This scheme was initiated in 1957 and it took some time before the effect of it was felt. Up to March 1957, 108 tenders were secured for small industries of the value of Rs. 5,87,000. The subsequent progress can be seen from the following table.

Year	Tenders Secured for Small-Scale Industries	Value
1957-58	580	Rs. 62,15,000
1958-59	1,766	Rs. 2,56,12,000
1959-60	2,055	Rs. 2,64,81,000

All the items purchased by the D.G.S. & D. and Railways are classified in four groups. Group I and

Group II are those items that can only be made by large industries; Group III includes the area where small and large industries can compete, but where small industries get a 15 per cent price preference; and Group IV is reserved for small industries.

Recently the Railways have started purchasing from small industries in full swing and in January 1961 they placed 1,858 tenders of the value of Rs. 26,19,000 on small industries.

This shows that small industries have come up in quality to the specifications laid down by the Government. This in itself is a great achievement and a stepping stone to building small industries as a sound base of the country's development.

There is a credit guarantee scheme of the State Bank of India, under which, against the authority of the Corporation, the small industries are allowed to purchase 100 per cent of their requirement of raw materials, on credit, to meet their obligations in fulfilling the contracts secured through the help of the Corporation.

It is common knowledge that small industries always feel the scarcity of components if these components are not manufactured in India and are imported. To help some of these industries in getting the required components at reasonable prices, the Corporation imports various items in short supply, as for example bicycle components. The Corporation has imported and supplied bicycle components worth Rs. 1½ crores, and knitting and hosiery needles worth Rs. 19 lakhs to small industries.

The Corporation has started two Prototype Production Centres, one at Okhla and the other at Rajkot, for training higher grade technicians, foremen, etc., and for designing and producing prototypes of small machine tools which can then be manufactured under licence by the small industries. Lastly, there are what are called Industrial Estates. The idea came up in 1955 and Industrial Estates were constructed by the Corporation in Okhla and Naini. Covered factory space was offered to small industries at a cheap rate of 0.8 nP. per sq. ft. Later, similar estates have been started by State Governments at Baroda, Poona, Rajkot, Surat, Kolhapur, Ahmedabad and other places.

As mentioned before, there is no sanction necessary for starting a small industry. You can get the technical advice from the Small Industries Service Institute and decide on the type and size of industry you wish to start. You can purchase the machinery if it is available from indigenous suppliers or approach the Corporation to supply it on hire-purchase basis, or apply for an Essentiality Certificate to your State Director of Industries and, after receiving it, apply to the Chief Controller of Imports and Experts or the Controller at Ports, as the came may be, for the licence.

Financial loans are given to small industries by the State Director of Industries under the State Aid to Industries Act, and by the State Finance Corporation. The Director of Industries may give Rs. 1,000 on personal bond, Rs. 5,000 on personal bond of two

persons and upto Rs. 10,000 after taking your assets as security. In the last case, the loan will be limited to 75 per cent of the valuation of the pledged assets. Application for more than Rs. 10,000 are processed by the State Financial Corporation which may give 50 per cent of the pledged assets and may also ask for collateral security. This loan is given for factory construction, acquiring capital assets, expansion programme and working capital. The interest is between three to five per cent.

The State Bank of India also gives working capital under its Pilot Credit Scheme.

It is true that there are lots of complaints heard against the Institutes and the Corporation, especially that there is long delay in getting work done from these bodies. Any organisation, if it develops at such a rapid rate, creates a vacuum in administration and one is sure that the organisations will settle down and eliminate the defects to gear up their contribution to the target of development set by the Third Five-Year Plan.

The only defect in the whole system is the fact that no one can guarantee the steady supply of raw materials to a small industry. It is surprising to note that the Government is spending vast sums of money in developing small industries but at the same time is completely indifferent to this basic need of small industries. The small industries have to fill up a very elaborate form for an Essentiality Certificate whenever raw materials are required. The Director of In-

dustries cuts down the requirement to maybe half and gives the Essentiality Certificate.

Then the application is forwarded to C.C.I. & E. or J.C.C.I., who, like the proverbial old lady with a pair of scissors, cuts down the recommended quantity to a ridiculously low level and, thus, all get the satisfaction of having done their job satisfactorily. There have been many cases where this process has left an industry with the licence for only one or two months' requirements of raw materials and it has to depend on the purchase of raw material at very high prices from the market.

This vicious circle has started with the basic premise that all small industries are in the habit of inflating their demands and hence cannot be trusted, and the cut is introduced at every level, but no one cares to investigate why the same material is still available at sky-high prices in the market. The material in the market has also come through the licence-holders who have received licences from the C.C.I. & E. No one investigates this, but they take the easy way out, of penalizing a small-scale industry, because it has no Godfather like the Development Wing. This is the only pitfall for small industries.

This is only an outline of how to start an industry. While the technicalities can be learnt, it is essential to remember that ultimately the qualities of initiative and enterprise are the determining factors in establishing and successfully operating industries.

2

Corporate Taxation in India

S. V. Ghatalia

CORPORATE taxation in India is a major source of revenue to the Government. It accounts for nearly 50 per cent of the direct taxation collected by the Government. Most of the profit-earning activities are carried on under a company form of organisation and, that is why, in recent years, the company as a class of tax-payer, has emerged as one of the largest in the country.

Comparing our taxation with that in other countries, it is found that tax rates in our country are extremely high. The high rates of taxation can be attributed to the fact that, in our country, taxation is designed to fulfil three functions, viz.,

(i) to provide finance for the Five Year Plans;

(ii) to act as an instrument for shaping the economic development of the country; and

(iii) to reduce inequality of wealth and income.

However, more often than not, it is forgotten that taxation policy should be so devised as not to act as a disincentive to work and capital formation.

By reason of heavy incidence of taxation on companies, the tax factor has emerged as one of the most important factors which has to be taken into account while taking top managerial decisions. In absence of forethought and planning in regard to taxation, one may unwittingly get entangled in a complication which may result in an unforeseen tax liability or disadvantage.

Before embarking on any economic venture, it is necessary to find answers for the following:

(1) What will be the capital structure?

(2) How will the long-term loan be repaid?

(3) What should be the dividend policy?

(4) How is the expansion programme to be financed?

(5) On what terms and basis is foreign collaboration (financial or technical) to be sought?

Company — A Taxable Entity:

Let us consider the basic structure of company taxation. Under the general law, a company is a juristic person and, as such, it is a separate unit of taxation. Accordingly, under the Income-tax Act, a company is a separate entity for tax purposes. The taxability of profit is not exhausted once it has borne

the tax at the hands of a company. When the company releases the profit by way of dividend to its shareholders, it again becomes liable to tax. This is based on the proposition that the individual shareholders and the company are two separate legal entities.

The next important point is that the character of the profit in the hands of the company does not remain the same when it passes on to the shareholder. Suppose a company earned agricultural income or a capital gain. Agricultural income is exempt from tax in the hands of a company. Capital gains was exempt in the past. But, nevertheless, when these exempted profits are distributed by way of dividend, the dividend does not retain the same character as the profit out of which it is distributed and consequently becomes taxable in the hands of the shareholder. This was a bone of contention for quite some time. Only a few years ago, the controversy was set at rest. It is now a well-known principle that the character of an income in the hands of a shareholder is not the same as in the hands of a company. So, it is possible that the income may be exempt in the hands of a company and yet it would become taxable in the hands of a shareholder.

"Company" :

The next important point for the purpose of taxation is :

What is a company? Under Section 2(5A) of the Income Tax Act, a company means—

(i) an Indian company; or

(ii) any association, whether incorporated or not and whether Indian or non-Indian, which is declared to be a company by general or special order of the Central Board of Revenue; or

(iii) a company assessed as such up to assessment year 1947-48. An Indian company is defined by Section 2(7A) which, broadly speaking, means a company incorporated in this country.

Therefore, a company should fall under any one of the three categories to be assessed as a company under the Income-tax Act. By virtue of the power given to the Central Board of Revenue, it is open to the Board to declare any Association, whether incorporated or not, as a company, and the option is given to the Board. No Company or association can as a matter of right claim that it must be declared to be a company.

A foreign company does not automatically become a company in this country. It has got to be declared a company by a special or general order of the Central Board of Revenue. Therefore, when a foreign company wants to operate in this country, the question is whether it is to be declared as a company or not. If it is not declared to be a company, it will be treated as an association of persons.

A non-resident foreign association of persons, according to section 17(1), will pay tax at 49 per cent (30 per cent income-tax **plus** 19 per cent super-tax

or appropriate rate of super-tax whichever is higher). As against this 49 per cent, the taxation incidence on a foreign company is 63 per cent. Therefore, if a company has got a small income, it is worthwhile not to get declared as a company and wait till the Central Board of Revenue on its own declares it as a company. But if the income is likely to exceed about Rs. 1,25,000/-, from that point onward, the association's income will be taxable at an aggregate rate higher than 63%. Therefore, initially one has to forecast what profit the foreign company is likely to earn. If it is going to make a large profit, it would be to its advantage to go to the Central Board of Revenue and request that it be declared as a company.

Residential Status :

The tax liability of any taxable entity under the Income-tax Act depends upon its residential status. So far as a company is concerned, either it will be resident or non-resident. Section 4A of the Income-tax Act defines a resident company. For the determination of the residence of a company, two tests are laid down. If it fulfils any one of the two tests it becomes resident. The alternative tests are : Either (i) it is an Indian company, or (ii) the control and management of its affairs is situated wholly in India. Therefore, if the control and management of its affairs is situated wholly or partly outside India, it can be held to be a non-resident company. The meaning of the words "control and management" means the seat of the directing power. It does not mean the **de jure** control. It is

the **de facto** control which is material for determining where the control and management of its affairs is situated. If a company is a resident company, it will pay tax on its world income. If it is non-resident, it will become liable to tax only on its income in India and will not become liable to tax on its income outside India.

Comparison with other Assessees:

It is worthwhile comparing the taxation of a company with other cases. A company is given special treatment under the Income-tax Act and special types of provisions have been laid down which apply only to a company. The first distinction is in the rate structure. So far as other assessees are concerned, there is always an initial exemption and then a graduated rate of tax, both for Income-tax and Super-tax. In all the three respects, a company differs. A company is liable to tax on the whole of its profits without any initial exemption. If it earns even one rupee, it must pay 45 nP. as tax. Secondly, the rate of tax of a company is flat, no matter what the size of the income is. It does not increase with the increase in the income nor decrease with any decrease in the income. It is a constant structure and today, for an Indian company, the tax rate is 20 per cent income-tax and 25 per cent super-tax, making a total incidence of 45 per cent. This is the position under the new scheme of company taxation which has recently come into force.

Under the new scheme of company taxation, if a business is run by a small man, he cannot afford to

convert his business into a limited company because for every rupee of the profit, he will have to pay 45% tax **plus** the appropriate rate of tax on the dividend income from that company. Therefore, one major fact of the new scheme of company taxation is that the conversion by a small man of his business into a limited company entails heavy incidence. To allow a small business man to have the benefit of limited liability, it is necessary that there must be a provision corresponding to the one in U. K. for a limited partnership.

The fourth point of distinction is that, even though a company, like any other assessee, is liable to tax, on capital gains, the tax rate is separately prescribed for a company. The tax rate for a company on capital gains is 30%,—20 per cent income-tax and 10 per cent super-tax. Unlike other assessees, for whom the first slab of Rs. 5,000/- is exempt from capital gains tax; in case of a company, every rupee of capital gain becomes liable to tax. Similarly, in the case of individuals, if there is a capital loss not exceeding Rs. 5,000/- it cannot be carried forward and set off against future gains, but in case of a company, whatever be the amount of capital loss, the company will be entitled to the carry-forward and set off against future capital gains.

The next distinguishing feature for a company relates to the provisions of Section 23A. It is a very complicated section and while we need not go into the complexities, it is necessary to understand the basis and reasoning behind Section 23A. A company form of organisation is resorted to, most often, by people

in the high income brackets, so as to reduce the incidence of super-tax. The object of this section is to see that by simply forming a company and allowing the profits to remain in the company, one cannot escape the high rate of super-tax. Section 23A applies, broadly speaking, to all closely held companies, private or public. The distinction between private and public companies, as it obtains in the Companies Act, does not apply to Section 23A. It lays down certain requirements to distinguish whether a company is a "23A Company" or "non-23A company". Suppose, a company happens to be a 23A company, then it is subject to a provision for compulsory distribution of dividend up to a prescribed percentage. In the case of an industrial concern, it must compulsorily distribute 50% of its profits. If it does not distribute the prescribed percentage of profit as dividend, then the company is subject to what is known as a penal super-tax. The penal super-tax in case of an investment company is 50% and in the case of other companies, 37%. It must be noted that once Section 23A is contravened, the entire amount of undistributed profit becomes liable to penal tax even though dividend might have been declared up to an amount which is just Rs. 10,000/- short. In other words, if the undistributed profit is Rs. 1 lakh, super-tax will have to be paid on Rs. 1 lakh and not on the amount one is short of in declaring the dividend.

The sixth feature relates to Section 15B, which deals with the relief on donations to charitable insti-

tutions up to $7\frac{1}{2}\%$ of total income; in the case of all other assessees, these donations are exempt from both income-tax and super-tax but so far as a company is concerned, the exemption is available only for income-tax and not for super-tax.

Categories of Tax :

Under the present scheme of taxation, a company is liable to the following types of taxes:

(i) Income-tax.

(ii) Super-tax.

(iii) Capital Gains Tax.

(iv) Penal Super-tax under Section 23A.

(v) Bonus tax (now reduced from 30% to $12\frac{1}{2}\%$)

and until recently :

(vi) Excess Dividend Tax.

(vii) Wealth Tax.

Exemptions :

A company is entitled to the following exemptions:

1. In respect of capital gains, exemption is given on capital profit arising on transfer of assets by a 100% holding company to a subsidiary Indian company. It may be noted that the reverse is not true, i.e., if the transfer of assets is made by such subsidiary company to a 100% holding company, the said exemption is not applicable.

2. Under Section 15C, if an industry is newly established, then, for a period of approximately five years, it is entitled to an exemption of profits equal

to 6% of the capital employed. What is the capital employed is to be determined according to the rules framed by the Central Board of Revenue. The said rules are rather ambiguous. This exemption is available to all assessees, whether a company or not, provided the industrial undertaking is established at any time between April 1, 1948, and March 31, 1966, subject to certain other conditions being fulfilled. A special concession is given to the companies under Section 15C(4) of the Act according to which tax shall not be payable by a shareholder on so much dividend as is attributable to the exempt profits. This is an instance where exemption available to the company is also extended to a shareholder. The provision is that when a company declares dividend which is attributable to Section 15C profits then that portion of the dividend is exempt in the hands of the shareholders.

Until recently, most of the companies did not realise that for the purposes of Section 15C(4), it is open to a company to segregate the exempt profits and non-exempt profits and it is possible to declare a dividend wholly from the exempt profits. Some companies have done it and they should certainly be entitled to an exemption of the whole of the profits on the ground that it has come entirely out of the exempt profits. The moment the companies started doing this, in the Finance Act of 1961, the Government brought in an amendment by way of an Explanation that how much portion of the dividend has come out of exempted profits will now be determined according to

the rules to be framed by the Central Board of Revenue. In framing this rule, the Goverment will be put to the test of honesty for if it is sincere in giving the exemption to the shareholder, it will have to frame a rule stating that dividends shall be deemed to have come first out of exempted profits and then out of the non-exempt profits. Otherwise, for centuries together, shareholders will never be able to get 15C exemption as the exempt profit will always remain embedded in the reserves of the company.

One point of practical importance in regard to Section 15C is that, exemption is said to be for 5 years, but in actual practice it may not be for five years. The provision is that exemption will be given in the year in which production is commenced, from the date of production and four years more. Suppose production started on the last day of the accounting year, then one will get exemption for four years and one day. Therefore, a wise assessee would find out exactly when the production is to be started and then select his accounting year, which he is entitled to do, in such a manner so as to get the benefit of tax relief for the entire year and not for a broken period.

3. The next exemption is under Section 23A. This Section does not apply to a company whose 100% shares are held by a non-23A company. Suppose, by the test laid down by Section 23A, a company is not deemed to be a public company, but if the shares of this private company are held entirely by a public

company which is a non-23A company, then Section 23A is not applicable to such a company.

There is one more exemption under Section 23A which has been conferred recently by the Finance Act of 1961. Suppose there is a company 75% of whose share capital is held by an institution or a fund which is charitable in the sense that its profits are exempt under Section 4(3), section 23A does not apply to such a company. This concession is given because Section 4(3) has been amended very radically. In view of this concession, where 75% of the shares of the company are held by such charitable trusts, a benefit will accrue to those holding 25% shares in such companies on account of Section 23A not being made applicable to such companies.

4. The next exemption is under Section 56A. It is well known that with a view to rapid industrialisation of this country we had to invite considerable financial collaboration from foreign companies. The foreign companies were deterred from investing money in this country because of the high rates of taxation. With a view to encouraging foreign investment in India and since the Government was very keen on promoting certain basic industries, Section 56A was enacted.

The scheme of this Section is that if a company holds shares in another company and if it fulfils the conditions laid down in Section 56A then the intercompany dividend will be exempt from super-tax.

This section would apply only if both the receiving and paying parties are companies; it will not apply to an individual. The conditions are that the company paying dividend must be an Indian company incorporated after March 31, 1952; secondly, it must be engaged in one of the 21 basic industries mentioned in Section 56A, which corresponds more or less to Schedule I of the Industries Development & Regulation Act; and, thirdly, it must be a company to which either Section 15C relief was available or would have been applicable but for the fact that 5 years have expired. If these three conditions are fulfilled, then exemption under Section 56A would be given.

The third condition about applicability of Section 15C might give an idea to a layman that this exemption is co-extensive with the exemption under Section 15C. But this is not so. The wording is clear that once Section 15C has become applicable to a company, it fulfils the condition. Therefore, the exemption will be available as long as section 56A is in force.

Section 56A extends the exemption also to an existing company incorporated before March 31, 1952, in so far as any fresh capital is raised by such company by public subscription after February 28, 1953, for the purpose of increasing the production of or starting a separate unit of any one of the specified industries. In such a case, if any company is holding old shares as well as new shares, it will be entitled to exemption only on the dividend of new shares. Such a company

will be well advised to sell the old shares and acquire new shares in order to get exemption of super-tax on the entire dividend.

5. We now come to Section 49BB. I would not like to call it an exemption. We are aware that before the new scheme of company taxation came into force, the income-tax paid by the company was refundable to the shareholder when dividend was distributed. Now, with the new scheme of taxation, this refund of income-tax is not allowed even if the dividend is received out of the profit taxed under the old scheme. By way of concession, Section 49BB has been enacted. It says that if a company distributes dividend out of the profits prior to the new scheme of taxation, then the company will get a rebate of 10% on such distribution. But it is well-nigh impossible to get this relief because it is provided that the dividend should be deemed first to have come out of the current year's profit and then the previous years' profit. It would be difficult to find a company in these days of prosperity falling on such evil days as to draw upon its old reserves for paying a dividend.

6. Under the provisions of Finance Act, 1961, rebate of super-tax is given on inter-company dividends.

7. From assessment year 1961-62, on the royalty payable by an Indian concern, in pursuance of an agreement made after April 1, 1961 and approved by the Central Government, the tax rate is reduced from 63% to 50%.

Recent Concessions and Reliefs :

From the discussion so far, it would appear that there is very heavy taxation on a company, but only a few years ago, the position was much worse. The present Finance Minister, Mr. Morarji Desai, deserves a rich tribute for the realistic and fair approach to the question of company taxation. One may differ from him on many points, but so far as relief which he has given to the companies is concerned, there cannot be two opinions. He must be congratulated on his boldness in eliminating the various inequities which were imposed on the corporate sector by his predecessor. It will be worthwhile recounting the various hardships which have been recently removed:

(i) From assessment year 1960-61, a new scheme of company taxation was introduced under which the tax rate of companies was reduced from 51.5% to 45%. But, at the same time, the provision for giving credit to the shareholders for the tax paid by the company was abolished.

(ii) The Wealth Tax on companies was abolished from assessment year 1960-61.

(iii) The most invidious and inequitable tax on excess dividend was expunged from the tax statute from the assessment year 1960-61.

These three major concessions have given great encouragement to the corporate sector. Apart from this, several other important concessions have been given.

Bonus Tax:

(iv) The most important of these is the reduction in the rate of tax on bonus shares. Until now, the rate of tax was 30% on bonus issue—payable by the company and not the shareholder. This rate was so high that no company could ever think of capitalising the reserves. The rate has now been reduced from 30% to 12½%. This concession is not to be looked at merely as a reduction in tax, but it has a far-reaching economic effect. Technically, a bonus tax cannot be justified because it amounts to taxation of profit which has not passed from one entity to another. The profits are still retained by the company. Therefore, the tax on such shares cannot be justified merely because the company passes an entry in its books of accounts transferring its reserves to its Capital account. One cannot also ignore the fact that the bonus share is a device to avoid personal taxation and, hence, there could be some tax on bonus shares. Also it could only be in the hands of the company as a purely preventive measure. What is more important is to see that the tax is not so high as to prevent legitimate capitalisation of profit. Capitalisation of profit is an important device for a company to plough back its profit, and the retention of profits in a company strengthens its financial structure. The reduction of bonus tax will widen the equity base of the company and restore the imbalance between the paid-up capital and fixed assets.

It is a sound principle of company finance that any long-term investment must always be financed out

of long-term source of capital. Therefore, the general rule is that a company must at least find sufficient capital to be able to finance its fixed asset investment. With the present reduction in bonus tax, companies will be able to bring their share capital in line with their investment in fixed assets. In the absence of capitalisation of reserves, one significant misunderstanding that existed was that companies were said to be profiteering when on a ten-rupee share a dividend of Rs. 15/- was given. A layman would not understand that the rate of dividend should be related not to the share capital alone but to the entire equity of the shareholders consisting of share capital and reserves. Therefore, with the issue of the bonus shares, the return on shares will appear more in line with reality than before.

One objection in regard to bonus share issue is that it may to some extent prejudice a small shareholder. But, it is only the extremely small shareholder that is affected adversely and that too not personally. His only grouse could be: "Why does the company pay $12\frac{1}{2}\%$ tax on the bonus issue?" The small shareholder would prefer dividends to bonus shares. But anyway, the objection cannot be considered to be very significant. When a large majority benefits by the issue of bonus shares, the claim of a very small minority cannot be allowed to come in the way. The small shareholder in any case will have a benefit in that when he sells the bonus share, he being a small shareholder, his capital profit will probably be below Rs. 5,000/- which is not liable to tax.

The Finance Minister must have very shrewdly estimated that the yield of tax on bonus shares at 12½% will be much more than if the rate is 30%. It appears that such estimate would come correct because immediately following the announcement in the reduction of bonus tax, there has been a spate of bonus issues. It can be confidently stated that at 12½%, more tax will be collected than at 30%.

Another technical point in regard to the issue of bonus shares is that if a company's reserves have been built up partly out of 15C profits and partly out of non-15C profits, it will not be wise to capitalise the reserve built out of 15C profits which, when distributed, will be exempt in the hands of the shareholders. The capitalisation of such profits would mean that these profits can never be distributed as dividends. In view of this, a company should segregate its reserves which have been built up out of 15C profits and not capitalise them and keep them free for distribution so that at a later date the exemption can be claimed under Section 15C (4) of the Act. Only reserves consisting of non-15C profits should be utilised for the purpose of issue of bonus shares.

In view of the concession in the rate of bonus tax, one may believe that the Government has now finally accepted the principle that bonus shares should not be taxed in the hands of shareholders. It is necessary to dispel such an impression because the Income-tax Bill, 1961, seeks to modify the definition of the term "dividend". Under Clause 2(22) of this Bill, a pro-

vision is made under sub-clause (b) that issue of bonus preference shares to preference shareholders shall be deemed to be a dividend and hence liable to tax. The amendment has a far-reaching effect inasmuch as it enunciated a proposition that the bonus shares can become a dividend in the hands of the shareholder. This provision must be very strongly opposed because once it is allowed to get on the statute book, there is nothing to prevent the Government, later on to remove the word "preference", on the plea that it is a harmless amendment.

(v) Important concessions have been given by way of rebates of super-tax particularly on inter-company dividend.

(vi) Section 56A of the Income-tax Act has been amended with effect from 1960-61 and the list of basic industries is considerably enlarged.

(vii) Under Section 23A, the percentage of shares to be held by the public, in case of industrial companies, has been reduced from 50% to 40%, thus permitting the majority holding of a company and at the same time not applying Section 23A of the Act.

(viii) Lastly, the Preference Share (Regulation of Dividend) Act, 1960 has to some extent mitigated the hardship caused to the Preference Shareholder as a result of new scheme of Company taxation.

Further exemptions and reliefs suggested :

Having considered the incidence of taxation and the exemptions and reliefs, let us examine what are the hardships to a company which still await relief.

(i) Under Section 10(4A) of the Act, the Income-Tax Officer is given a discretion to disallow the whole or part of any expenditure incurred by a company which results directly or indirectly in the provision of remuneration, benefit or amenity to a Director or a substantial shareholder, if such expenditure is excessive or unreasonable, having regard to the legitimate business needs of the company and the benefit derived therefrom. In actual practice, this amendment has caused considerable hardship because some Income-Tax Officers disallow such items on flimsiest grounds. The legislation, by conferring this power on the Income-Tax Officers, did not intend that they should sit on judgment on every rupee of the emoluments paid to every director or a substantial shareholder. It is necessary to provide for adequate safeguards by suitable amendment of the law and clear instructions to the Income-Tax Officers. This is essential in view of the double taxation involved because such disallowance to the company nevertheless does not exempt the recipients from tax on such disallowed remuneration.

(ii) The incidence of tax on **inter-company dividend** is still very heavy as it amounts to a triple taxation, viz., in the hands of the first company, secondly, in the hands of the receiving company and, thirdly, in the hands of a shareholder. There is a scope for further relief in such cases.

(iii) The recent amendment of provisions relating to **Development Rebate** in the event of amalgamation is defective as it gives relief only in the case

of amalgamation of two companies by forming a new company. The schemes of absorption generally involve absorption of one company by another i.e., there is one liquidation and no formation, whereas the relief in regard to Development Rebate is available only if there are two liquidations and one formation.

(iv) Under the present Section 15C of the Act, if any old assets are used for the new unit, the company may lose the entire exemption. It is, therefore, necessary to provide that in the expansion programme if a company has used old assets to a very small extent with a view to effect economy and save foreign exchange the company should not be deprived of the exemption under Section 15C of the Act.

(v) Under Section 56A of the Act, hardship is likely to be caused by interpretation on the part of the department that exemption on dividend on **fresh issue** is available only if it is by **public subscription**, i.e., not including offer to existing shareholders. It appears that the department's interpretation is incorrect, but to remove any doubt on the point a clarification or the amendment of law is called for.

(vi) Technically, in case of new industrial companies, any expenses incurred before the commencement of business are not allowable. Under the present system of controls, it always takes a company quite some time to obtain import licences for plant and machinery, for getting the sanction for foreign exchange and to obtain the finance before the production can be commenced. The expenses incurred

during this time lag between the formation of a company and commencement of business should be allowed. There must be a suitable provision under Section 10 for allowance of such expenses.

(vii) By the Finance Act of 1961, a ceiling has been fixed on allowance of Entertainment Expenditure in case of a company. The minimum limit is Rs. 5,000/- and the maximum is Rs. 1,00,000/-. In between, there is a graduated scale based on the profits made by the company. This amendment is open to the following objections :

(a) The restriction applies only to a company.

(b) The entertainment expenses and the profit of the current year cannot be related. Very often, the benefit of expenditure on entertainment may be a deferred benefit.

(c) Some businesses by their very nature are required to spend more on entertainment than others and hence a common yardstick should not be applied.

(d) Entertainment expenses may be heavy in some years and much less in other years. Hence, even though over a period of time the expenditure is reasonable, in a particular year it may be considered to be in excess.

In view of these objections, it is submitted that ceiling on Entertainment expenses should be removed and instead a little more scrutiny on Entertainment expenses should be imposed so that any lavish, ex-

travagant or ostentatious expenditure is not allowed to be deducted. While restricting expenditure on entertainment, by a touch of irony, a provision is made for giving relief to the new hotels under Section 15C of the Act. A limit on entertainment expenses may to some extent nullify the benefit proposed to be given under Section 15C.

Benefit of company form of organisation:

Even in spite of the heavy incidence of tax on companies, for persons with large income, it is beneficial to earn the income through a company because the rates of tax for an individual are also equally very heavy.

Section 23A of the Income Tax Act is designed to prevent avoidance of super-tax by shareholders through retention of earnings in closely held companies which being separate entities for tax purposes, are subject normally to lower rates of super-tax than those applicable to shareholders in the upper brackets of income. Under the new scheme of company taxation, for persons in higher income groups, it is beneficial to form a company in so far as the profits are retained in the company they would bear tax only at 45% and no further taxation would arise until distributed by way of dividend.

In case of persons in still higher brackets of income it is even worthwhile to contravene Section 23A and pay Penal Super tax. In such a case the position is as under:

Company's profit:		Rs. 100.00
Less: Company's Income Tax and Super-tax:		Rs. 45.00
Balance—Saving:		Rs. 55.00
Less: Penal Super tax @ 37% :		Rs. 20.35
NET SAVING.	Rs.	Rs. 34.65

Suppose a person has reached a rate of 84%. His savings after tax will be only 16% if he himself earns the income. But suppose he earns it through a company and contravenes Section 23A, the net saving in the hands of a company will be 34.65%. Thus, retaining the profit in a company instead of taking it himself will give him a saving of 18.65%.

Another favourite method of reducing tax liability is to make the company a non-23A company so that provisions for the compulsory distribution do not apply and in that event profits retained by the company will bear tax only at 45%.

The above is based on the provisions of the Indian Income Tax Act, 1922. On April 1, 1962, the Income Tax Act, 1961, comes into force. The scheme of company taxation as discussed above is basically not changed. However, certain changes have been made in the existing provisions and important new provisions have been added.

3

Company Law & Some Problems

F. R. Ginwala

THE development of public interest in company legislation began with the increasing awareness of the economic background of the country after her independence. The increasing diffusion of property rights in the corporation through multiple ownership of stocks and shares and the simultaneous concentration of control and management in the hands of a few as typified by the Managing Agency system created special problems for the government and made it aware of its protective role. Only after independence did our people feel that the national task of developing corporate enterprise could not be performed single handed either by the State or by free enterprise. In order to fulfil their expectations the people felt that the state should play a major role in the country's economic development. It was under these circumstances and

in the light of experience gained from the working of mushroom companies formed during the post-war boom period that the Government of India took up the revision of the 1913 Act. The Companies Act of 1913 was one of the most under-administered Acts of the Central Government. Its administration was left mainly to the State Governments who took little interest in its enforcement. Its provisions remained largely ineffective on account of the absence of proper administrative arrangement for the enforcement of its provisions.

In October 1950, the Central Government appointed a Committee of 12 members under the able chairmanship of Mr. C. H. Bhabha to go into the entire question of the revision of the 1913 Act with particular reference to its bearing on the development of trade and industry in the country. On the recommendations of the Report of the Bhabha Committee, a Bill was passed by Parliament in November 1955 which ultimately emerged as the Companies Act of 1956.

It is a tragic fact that although the Act was the outcome of a prolonged and detailed consideration, both inside and outside Parliament, it remained a subject of much criticism which kept on smouldering.

The general discontent against the Act made the Government realise that it still needed adjustment. An **ad hoc** committee of 5 members was appointed with Mr. A. V. Visvanatha Sastri, Retired Judge of the Madras High Court, as its Chairman, to report its

suggestions for remedying the situation which had arisen from the working of the Act. The Sastri Committee was asked to adhere strictly to the terms of reference which intentionally excluded considerations of general economic and social policy from the ambit of enquiry. The Bill amending the Act was discussed in November 1960 and was eventually passed and received the assent of the President on December 28, 1960.

It is often asked that while democracies work on the basis of faith in mankind why is it that a statute like the Companies Act is based on distrust. The answer is that in the modern world, both life and business have been so complicated that elaborate precautions have to be made in the statutory provisions. Although shareholders are presumed to know what kind of company they have invested their money in and to what sort of men they have entrusted its management, the law is expected to protect their equity from the risks of enterprise. It is for the shareholders to insist on a full information about it; law can help here by insisting on information. The other reason for the elaborate provisions is that shareholders in our country are not as much enlightened as those in other highly industrialised countries. Adequate provisions are therefore made in the amended section 84 so as to prevent fraudulent issue of shares, and Section 111 is amended so as to require a company to disclose reasons for refusing to register a transfer to transmission of shares; and to enable Government to raise an adverse inference if

a company fails to make such a disclosure. The amendment of Section 193 by way of precaution against falsification of minutes of the Board and the Annual General Meetings, and the amendment of Section 217 providing for Director's Report to include material changes and commitments affecting the financial position of the Company between the date of the Balance Sheet and Report and many other provisions of the amended Act are intended for the benefit of the investing public.

One might well ask why the amended Act contains so many regulatory provisions while the directors should be competent to judge, what is best in the interest of the company and its shareholders. The various regulatory provisions are intended to bring the business community in tune with the social environment.

Broadly speaking, the various regulatory provisions have been enacted with a view to ensuring that the management of companies was not sought to be vested in the hands of persons of questionable business antecedents, that the managerial remuneration proposed is not out of proportion to the financial resources of the company concerned, and that unfair business and anti-social practices are stopped. To give a few instances, Section 197-A prohibits the appointment of more than one of the four categories of managerial personnel, namely, managing director, managing agent, secretaries and treasurers, and manager; Section 259 requires the Government sanction in increasing the number of directors; Section 268 requires Government approval in respect of amendment of provision relating to managing,

wholetime or non-rotational directors; Section 269 relates to the appointment of managing or whole-time directors; Section 310 requires Government approval for increase in remuneration of director or manager; Section 311 requires Government approval for increase in remuneration of managing director or manager on his re-appointment; Section 326 which relates to appointment or re-appointment of managing agent; Section 328, relates to terms of office of managing agents, Section 329 which relates to variation of managing agent's agreement; Section 346 relates to changes in constitution of managing agency firm or corporation; Section 377, under which now a managing agent can no longer be appointed a Chairman of the Board; provisions of Section 408 and 409 authorise the Government to appoint directors so as to prevent oppression or mismanagement or prevent change in board of directors likely to affect the company prejudicially.

In the eyes of law, a company is like an independent person with its rights and liabilities appropriate to itself and its executive authority is vested in its board of directors whose duty is to see that the business is carried on in accordance with the memorandum and articles of Association. Some powers, it is true, may be reserved to the shareholders in the general meeting, and some can only be exercised by them under the Act, but there must inevitably be a large field of action in which shareholders in a company of a considerable size cannot directly exercise authority. These powers are accordingly vested in the Board of Directors. The

shareholders, therefore, cannot usurp the powers which are vested in the directors any more than directors can usurp powers vested in the general body of shareholders. So far as directors are concerned, however, there is no doubt whatsoever that they are under a legal duty towards their company to show reasonable care in the performance of their duties. If we examine the regulatory provisions dispassionately, we will find that most of them are intended to ensure better fulfilment of the purposes underlying the Act. In modern industry, elasticity and adaptability to changing circumstances must be of paramount consideration. Some company managements have become so immersed in their old habits and attitudes that they are inclined to overlook the need for a change and even resist it.

Article 19 of the Constitution confers a very important right upon every citizen in India to practise any profession, or to carry on any occupation, trade or business. Undoubtedly the right is to carry on business freely. But as has been often pointed out, none of the rights to freedom enumerated in Article 19 is an absolute right. This right of freedom must be viewed and appreciated in the social context. As the country develops, more and more social needs would have to be satisfied. It is, therefore, permissible under the constitution for the State to make law imposing, in the interest of the general public, reasonable restrictions on this right. But whether a restriction is reasonable or not must be judged not in the abstract but in the context of the times and in context of the social needs

and social urges. There is no absolute yardstick by which one can test whether a restriction is reasonable or not. Any restriction which arbitrarily or excessively invades the right cannot be said to contain the quality of reasonableness. The advanced countries of the world have accepted the fact that the fundamental interest of the joint-stock companies is a matter which must be deemed to be the concern not merely of shareholders, much less only of the directors or the managements, but also of the entire community. This is not to deny the vital stake of the shareholders in a joint-stock enterprise or the paramount responsibility of the Directors for the good management but only to emphasize that social control and regulation of human conduct and behaviour are as much an essential pre-condition of a stable and progressive growth in the private sector as in any sphere of our social life. It is in the interest of our industrial dynamics that this appreciation should grow quickly, and be more broadbased than it has been hitherto. From my comparative study of legislation on the corporate form of enterprise of many countries of the world, and particularly of Australia, Canada, New Zealand and South Africa, which have undertaken legislation similar to ours, I am convinced that the degree and extent of Government control and intervention depends upon the social and economic forces operating in the particular country.

Since the Companies Act came into force on April 1, 1956 a record number of new companies have been registered during the year ending 31st March, 1960.

The total number of new registrations was 1,452 accounting for an aggregate authorised capital of Rs. 160.5 crores. The total number of public companies formed during the year 1957-58 to 1959-60 was 210 with an authorised capital of Rs. 178.5 crores and the total number of private companies formed during the corresponding period was 3,298 with an authorised capital of Rs. 369.1 crores. Out of the 3,298 companies, 2,762 companies were formed in the four major states of the country, viz., Bombay, West Bengal, Madras and Delhi. From the new company registrations and their steady upward trend, we can see for ourselves that the earlier fears and apprehensions of the business community were not well-founded. The Government believes that the upward trend in company formation bears testimony to the constructive spirit in which the Act is administered. The regulatory provisions of the Act, however irksome they might be, have not deterred private enterprise in its initiative to work for the prosperity of the country. Our country's economy would have dwindled and collapsed long ago if Private Enterprise had not stood by the nation.

The amended Companies Act contains in Sections 617, 618, 619, 619A and 620 special provisions applicable to Government Companies. The basic obligations cast upon the companies and their managements under the present Act are equally applicable to both joint-stock companies set up in the private sector by private enterprisers and to companies which under the provi-

sions of section 617 are now called Government companies.

It is worthwhile to reflect on the growth of Government enterprises in the Corporate Sector during the last five years. The total number of Government Companies in which the Central and State Governments, separately or together, owned shares to the extent of 51% or more of their subscribed capital and which, as a result became Government companies, was 61 on April 1, 1956, when the companies Act of 1956 came into force. These 61 Government companies accounted for a total paid-up capital of Rs. 66 crores. In comparison with the number of 29,813 joint-stock companies as on April 1, 1956, the number of Government companies was very small but in terms of paid-up capital, their relative position was slightly better. It was at the end of 1959-60, the number of Government Companies was doubled. The total number of Government companies as at March 31, 1960, was 125 and their paid-up capital totalled approximately Rs. 477 crores, while the overall number of joint-stock companies at work was 26,921 having a total paid-up capital of Rs. 1,593 crores. Thus, in 1959-60, in terms of paid-up capital, the public sector accounted for about one-third of the total paid-up capital of the companies in the Private Sector. It is, however. important to mention here that out of the total paid-up capi al of Rs. 477 crores belonging to Government companies, over Rs. 300 crores related to one single Government Company, namely the Hindustan

Steel Limited which was originally set-up in 1954, with an initial authorised capital of Rs. 100 crores, later on stepped up to over Rs. 300 crores. Late entrants in the public sector were 23 companies formed during the year 1959-60. Of the 125 Government Companies at work during the period 1959-60, total number of Government companies exclusively and jointly owned by the Central Government with State Governments and private interests was 50 and out of these 35 companies exclusively belonged to the Central Government. The remaining 75 companies belonged exclusively to the State Governments.

Criticism against Government companies arises out of various reasons. It is observed that supervision over the working of Government companies is weak. Although the Auditors' reports contain serious adverse comments and criticism of Government companies, the Company Law Department as an enforcing agency of the Act has not taken any action against companies concerned or their directors and has accorded a differential treatment as regards compliance with the provisions of the Act as compared with companies operating in the private sector. I am not aware of any single instance where prosecution was ordered against a Government Company. But the provisions of the Act are strictly enforced against company managements in the private sector. We are not aware of any serious effort on the part of the Government to enlist support for law by Government companies.

The evil of concentration of economic power in the

hands of private sector is being checked while turning a blind eye to similar evils in the Public Sector. In this context, in order to realise the dream of new image of corporate form of enterprise, it is increasingly necessary that our politicians and legislators should see more clearly the emerging outlines of the bureaucratic system in our economy.

It is relevant to consider the working of bureaucratic system of management in a State enterprise. As far as I know, in between the Departmental head and junior clerk there are seven cadres of management. The set-up of administration in a Government undertaking normally comprises of the following cadres of management :—

(1) Junior clerks,
(2) Senior clerks,
(3) Assistants,
(4) Assistant Superintendents,
(5) Superintendents,
(6) Officers,
(7) Deputy Chief Officer,
(8) Chief officer or Departmental head or General Manager.

If a file or a paper passes from a clerk to the Assistant Superintendent, Superintendent, Officer and finally to the Chief Officer or the Departmental Head or the General Manager, it takes about fifteen days for that file or paper to come back to the clerk even if no one keeps the file or paper more than a day. It is not

only a drain on the financial resources, but it increases red-tapism, breeds inefficiency and curbs initiative. In private enterprise there are not so many cadres of management. The state enterprises should emulate the efficiency of the private sector.

There were many good reasons for tightening up the penal provisions because the objectives of the Act remained largely unfulfilled as the penal provisions in the Act were not sufficiently deterrent. They have now been made more deterrent to ensure scrupulous compliance with requirements of the Act. Section 614 A is introduced in the amended Act to enable the court trying any offence under the Act to compel the performance of the duty of filing the returns, accounts or other documents. Section 629 A is another new provision which provides penalty where no specific penalty is provided elsewhere in the Act. The stricter penal provisions might prevent undesirable elements in trade and industry from deliberately continuing to indulge in malpractices. But attempts to by-pass the provisions of law cannot be effectively checked until the overall standard of company behaviour in the country has risen and by and large the business managements look upon the concepts of the fiduciary responsibility of directors, or managing agents not only as an ideal to be worked for but also as a rule of conduct to regulate their day-to-day working.

The Act has imposed enormous duties and responsibilities on the middlemen in company managements. These middlemen are the Managing Directors, Secre-

taries, Managers, Accountants and other executives. In practice, these middlemen not only regard observance of the legal minimum as a matter of course, but observe a standard of conduct higher than the law prescribes. If law creates duties it is its function to confer powers on those who are made responsible for the performance of these duties because responsibility without power would create an impossible situation. It is unfortunate that the framers of law have not visualised the need for providing adequate safeguards while enacting sections of the Act which impose enormous responsibilities on these middlemen.

Considerable apprehension and misgivings have been expressed that the amended Act lacks practical wisdom, ignores the signs of the times and needlessly makes it difficult for the business community to find the proper meaning and significance in many of detailed provisions of the basic law relating to joint-stock companies. A point in instance is the new section 43A. This section which has been on the Statute book without much care and intelligent deliberation has led the enlightened business community to think deeply about the future of collaboration between Indian and foreign companies. The more thought we give to this section, the more we will find that there is an absence of realisation on the part of the reformers of Company Law that collaboration for the economic advancement is needed not only in the interest of economically underdeveloped countries but also as a step forward to a better integration of the world economy.

The philosophy underlying this section is that private companies which employ public money, directly or indirectly to a considerable extent, should be subject to the same restrictions and limitations as those applicable to public companies. The legal effect of this section is that a private company will become a public company with certain specified exceptions within a period of 3 months where not less than 25% of the paid-up capital of a private company is held by one or more bodies corporate. Such companies lose almost all the privileges of private companies. Many practical difficulties have been created by the ambiguous drafting of this section. The law does not state anywhere about the composition of the Board of Directors of companies which are deemed to be public. The minimum number of directors is at least 2 in the case of private companies and at least 3 in the case of public companies. The amended Section 287 provides that there should be at least 2 disinterested directors to form a quorum of a Board Meeting. Under Section 174, quorum for the general meeting of a public company is five members. Section 45 provides that shareholders are severally liable for debts where business is carried on with fewer members than seven in the case of a public company and fewer than two in the case of a private company. The deemed Companies for Section 43A Companies have thus to face these legal implications because they are required to comply with all the requirements of the Act except where any

relaxation is permitted by law. One does not know why these technical difficulties were not visualised.

Section 285 as amended requires the Board of Directors to meet at least once in every three calendar months. If one construes the Section in the context of what the legislature has said or aimed at in bringing about the amendment, there is no change in law at all. All that it intended to seek was to remove the anomaly which existed in the old section which made the interval of more than 3 months possible between one meeting and the next. The strict legal interpretation of Section 285 as amended would be that if a Board's meeting was held, say, some time in January 1961, the next meeting must be held on or before April 1, 1961. This practical difficulty arose because the Joint Select Committee did not make use of proper words while amending the draft Section as originally introduced in the Bill on the amendment of the Act. The citizens do not expect the legislature always to forsee every possible result that may ensue from guarded use of some words but they surely expect the legislature to indicate its intention with reasonable clearness. Clarity of language is, therefore, undoubtedly essential for proper administration of law. The law should not be kept in a state of uncertainty for it only leads to confusion. Nothing can be done now. We have to learn to be accustomed to the hasty nature of our legislative output and take consolation from what Khalil Gibran, the philosopher, said to a lawyer. He said: "You delight in laying down laws, yet you delight more

in breaking them, like children playing by the ocean, who build sand towers with constancy and then destroy them with laughter."

Ever since the Companies Act came into force, the interpretation of its provisions has remained in a state of uncertainty. By the time those responsible for the management of the companies had, with considerable efforts, familiarised themselves with its different provisions, they were obliged to switch overnight to a set of numerous new provisions. This added to the confusion. If we go to the lawyer or a solicitor he will not take the responsibility of giving any authoritative opinion but will advise us to seek the opinion of the counsel and thus pass on his responsibility. If we go to the auditor, he might try to pass on his responsibility to a lawyer. Ultimately when we go to a counsel, he might say that this is one view, this is the other view, this is yet another view and perhaps may confess that he himself does not know which view is correct. If we go to any officer of the Department of Company Law Administration and ask for guidance, he will express his opinion purely from the departmental point of view with a caution that it should not be taken as the correct legal interpretation of the Act, because he is afraid of his departmental instructions. We may take the matter to a higher level in the Department and explain our view that a particular provision of the Act is not capable of being complied with because it is defective and the courts of Law do not come to the aid of defective statute. We want the guidance of the Department be-

cause we want to observe the law. The Department will tell us: "Well what can we do; the policy of the Government is like that." If we insist on our point being clarified and quote legal opinion in support of the view, we will perhaps get a reply: "Well, we are not concerned with the view of the legal practitioners. We take a global view of the law." And we come back wondering what was meant by "the global view of the law".

It is of interest to know a few instances of such practical difficulties of the business community. In the course of an argument, the counsel drew the attention of the Court to a certain provision of the amended Companies Act. A high law officer of the Government of India happened to be in the court room. Their Lordships turned to him and asked, "Does the Government consult you while amending legislation?" He replied, "Yes, My Lords, at times". Their Lordships asked, "But were you consulted when the Companies Act was amended?" Quick came the reply, "No, My Lords, had I been consulted, I would have committed suicide long ago."

There is another instance. An executive of a foreign company after a conference of 45 minutes with his company's solicitor and the counsel, was not satisfied with the counsel's opinion and asked: "But why can't we have a clear opinion on this point of Company Law?" Prompt came the reply: "The law having turned out to be vague, and the lawyers vaguer still."

There is yet another instance where a company's

solicitor found several interpretations of the same section. In despair he advised his client: "The law is complex, uncertain, obscure and confused,— go ahead and file the documents with the Registrar. When things take a bad turn, we shall see."

When the Company law is in such a mess, it is unfortunate that there is such a strict enforcement of its new provisions and heavy penalties are imposed under Section 611 for late filing of documents. A human approach is lacking in the manner in which the Act is enforced. No one is perfect and even the most careful of us sometimes make mistakes. In fact, it is a true saying that a man who never makes a mistake will never make anything. This is not a climate for the strict enforcement of the penal provisions. Obligatory provisions and heavy penalties are themselves deterrent to improper conduct. The businessmen say that let indignation be reserved for, and indeed lavished upon, those guilty of fraud or dishonesty or who hide the true character of their transactions; but those who want to comply with the letter of the law as also the spirit underlying it should have the opportunity to understand the complicated piece of law. The amending Act was brought into force on December 28, 1960, the date on which the President gave his assent because it suddenly occurred to some wise man in the Ministry of Law that enactments passed during the year must be brought into force before the end of the year. Even after six months, the printed copies of the amended Act were

not made available to the public! Adding insult to the injury, the Government spokesmen now say that they are going to have stricter enforcement of the provisions of the Act because of the increasing knowledge and understanding of them on the part of the business community! I would ask the Government what opportunity has been given to the business community to understand the amended legislation imposing new penalties, adding imprisonment upto six months for contraventions which were punishable hitherto by fines only, making radical changes in the rights and duties of directors, making new provisions relating to Managing Agents, sole selling agents, managerial remuneration, and special audit by Government Auditors. Surely the Government cannot deny the basic concept that consent, not force, is the basis of the state and that the State cannot exist if its law is not intelligible to the citizens.

An overall picture of Company Law cannot be complete unless we know something about the Department of Company Law Administration which is entrusted with the duty of administering the complex piece of legislation which now consists of 675 sections, 13 Schedules and numerous forms. This Department in its present shape consists of a secretariat organisation with headquarters at New Delhi. There are four Regional Offices located at Bombay, Calcutta, Madras and Kanpur. Each regional office is in charge of a Regional Director. Although the Companies Act does not confer on him any statutory powers, the Depart-

ment has entrusted him with the duty of seeing that the provisions of the Act are satisfactorily implemented in his region. He is also delegated with wide powers with a view to promoting expeditious disposal of applications made by the companies to the Central Government. There is a Regional Solicitor under his establishment whose duty is to attend to the legal matters pertaining to the Department and advise the Regional Director and the Registrar in legal matters. There is a Departmental Accounts Officer who performs the duties of an Inspector when investigation into a company's affairs is ordered by the Government. Then, there is the Company Prosecutor who conducts prosecutions on behalf of the Department. Each State is in the charge of a Registrar. Whole-time Official Liquidators are for the present appointed in the States of Maharashtra and West Bengal. Thus the Department nurses and brings up a company, but has no experience and qualities of a good nurse.

When a default is noticed, on scrutiny of company's records, two notices, one of which is sent by registered post, are sent to the Company, the directors and the officers at default drawing their attention to the contraventions and requesting them to make good the defaults within the time mentioned in the notice. Normally no prosecution is launched if the default is made good within the limit of time indicated and the persons on whom notices are served satisfy the Registrar that the default was beyond their control or where it appears that the company had become defunct or that the

persons served with the notices were not responsible.

Offences under the Act are non-cognisable and action could be taken by the Court on a complaint by the Registrar or a shareholder or a person authorised by the Central Government.

There is a Company Law Advisory Commission with a Chairman and four members. As is now well-known, it is the duty of this Commission to enquire into and advise the Government on all matters enumerated in Section 411 which covers questions concerning company managements, such as the appointment, re-appointment of managing agents, secretaries and treasurers, managing directors, and whole-time directors, the change in the terms and conditions of their appointment, the variation in the managing agency agreements, the changes in the constitution of firms or companies acting as managing agents, or secretaries and treasurers, the increase in the remuneration of managerial personnel, etc.

A Technical Advisory Committee has been set up since the last two years and its advice is sought by the Department in matters involving legal and accountancy problems arising out of the administration of the Act.

The Company law will present only a picture of archaic and dignified confusion unless the State endeavours to preserve, and strengthen and develop the system of private enterprise in the organised sector of the economy and remove the existing tensions which

impede its growth and expansion. The country will not attain its proper heights unless the organised private sector in India is enabled to operate without impediments so that it may contribute its best to economic development.

4

Advertising and Marketing

A. S. Peerbhoy

INDIA is trying steadily to build an industrial economy. In the next few years, we will build more industries and push forward industrialisation to the next stage of mass production. For the ultimate success of an industrial economy will need mass production to make available more and more goods at a lower cost. Mass production will need mass markets—only through systematic marketing and carefully planned advertising can the consumption of Indian production be promoted bringing benefits to the consumer and helping to raise the standard of living.

Marketing

The modern concept of marketing places emphasis on the consumer, which means, manufacturing those goods which the consumer needs or will need. The

old concept is—sell what you make; the shift today is to make what can be sold.

Marketing has been described as all the functions that move the goods from the assembly lines into the consumer's hands. Facts are the basis of a sound marketing plan. The first step, therefore, is to gather facts about the market: who are the buyers, where do they live, what are their characteristics—their means, their likes and dislikes. In India this aspect cannot be more than emphasised, since new markets are being developed, new townships coming into existence bringing not only new area under development but also additional purchasing power.

The success of a product depends a great deal on the marketing plan; if the plan is well thought out and all its elements have been balanced against facts, the changes of establishing a particular brand of product are excellent.

Brand name is most important for a marketing operation. A brand is a symbol which identifies the product; it is a mark of distinction and gives to the product a position and the added value of being "special". For instance, "Dalda" is a brand name for Vanaspati, but the brand has become so popular that all vanaspati has come to be known as Dalda. This is an extreme example when the brand becomes so synonymous with the product, that the brand itself loses its special distinguishing characteristics.

A brand has five distinct characteristics :

Quality : Dinstinctive, one that may be relied upon

through repeated purchases of the same brand.

Value: Honest prices competitive with and in the same price range of the product it represents and equitable among consumers.

Competition: Vigorous and fair competition.

Advertising and Selling: Truthful and informative description to which it is related.

Progress: Continuous market study to maintain the products to the taste and fashion prevailing among the consumers and constant research embodying in the product and the value of scientific progress.

Advertising

Advertising has been described as salesmanship in print. The purpose of advertising is to make known a produce—to persuade the people to buy. The most important responsibility of advertising here is not to make false "claims" for the products. The word persuade is likely to be misapplied. Persuasion will work only up to a point to make a person try the product; but if the persuasion is based on such false promises as are not there, the user will never buy the product again.

The success of advertising depends not on a single sale but on repeat sales—the user must buy the product, be satisfied and come back to buy it again.

Advertising builds up sales and helps to establish the product as part of one's life. And this can happen only if the product is really good. The point that

concerns a serious-minded advertiser or advertising agent is: does the product fit into the general pattern of things? Will the product be used and re-used? A person may be tempted by the tall claims that advertising makes. It may induce a person to buy the product—but will he use it with satisfaction, will he keep on using it? Use and continuous use of the product is the real test of marketing. For example, the Ball Pen is a recent invention. When it was introduced, a definite place for its "usefulness" was found. In the case of the Ball Pen, the function advertising performed was to tell the public that a new writing instrument had been discovered. Then advertising persuaded and convinced readers that here was a product which would be practical and must prove useful. Finally, advertising proved these claims to be real, not imaginary. A good product is a strong foundation to effective advertising.

Sales Promotion is a continuous activity determined not by the demand of the present, but by the potential future demand which can be developed. Though at present there is in India a seller's market, soon we will face a situation when the supply will exceed the demand and intensive sales promotion will press forward awkwardly, to maintain previous sales in an increasingly competitive market.

It, therefore, becomes incumbent to observe carefully the relationship of the selling expenditure to the sales effected thereby—in its functional perspective the selling rupee must be spent effectively with a view

to securing a progressive future for the relevant industry and to maintain the industry's position in the market even when competition becomes intense.

Advertising forms a part of selling expenditure and its effectiveness depends upon the size of the allotted budget. Advertising's effectiveness stems from these four factors :

1. It creates new markets more rapidly, more intensively and less expensively than any other method of selling.
2. Advertising lowers cost for the consumer because it helps mass production, which in turn results in diminishing manufacturing and distribution costs.
3. Advertising brings about product improvement. There is a constant struggle to make the marketing rupee work more effectively and this acts inevitably as a spur to the development of better and better products.
4. Advertising cannot ultimately sell a poor product and advertising cannot sell too, products for very long in the competitive market if that product stands "still" quality-wise.

The success of marketing and advertising depends on a number of factors. What we need today, more than ever before, is to think of marketing as an integrated activity to smoothly move the products from their assembly lines to the consumers.

5

How To Run Your Office More Efficiently

Rustom Sohrab Davar

I WOULD like to divide the subject into two aspects; namely (I) Management of your office from the point of view of human beings; and (II) Management from the point of view of equipment or appliances. Normally, when we talk about office efficiency, the brand image projected (i.e. the impression created in the mind) is generally of addressing machines, duplicating machines, perhaps electronic computers, etc., and the principal question that arises is one of greater productivity through these machines. I would, however, like to stress more the word "Management" which has been defined as getting things done through people. Your office will be as efficient or otherwise as the people who man it.

I—MANAGEMENT OF MEN

The most important responsibility of the Manager today is human relations which affects every decision he makes. You as manager must provide the necessary environment of both good working conditions as well as challenging jobs. It is only then that you will be able to attract, or what is more important, keep good people and employees in your organisation. The most priceless assets in any company are those who work in it.

How will you meet today's challenge of increasing productivity and creative management? Where should we commence our analysis so that you may run your office more efficiently? If you were asked the question, "Who is the most important person in your life?" what would your answer? I have asked this question often and received replies such as "My father," "My mother", "My wife", etc. However the only honest answer to such a question would be "Myself". You are the most important person in your life. Therefore, you should start your analysis with yourself. Do not ask yourself the question "What do I expect from my subordinates?" Rather ask yourself, "What does my company expect from me?" As a Manager, your Company may well expect from you (1) Scientific Management, (2) Organising Ability, (3) Adequate Recruitment, Selection, Control and Motivation, (4) Proper Delegation, (5) Sound Decisions, (6) a Good Example, (7) Good Leadership, (8) Poise, (9) Foresight and (10) Initiative.

Scientific management can be broadly divided into five functions :

I FIXING OF OBJECTIVES
II PREPARING THE PLAN
III EXECUTION
IV EVALUATION
V INNOVATION

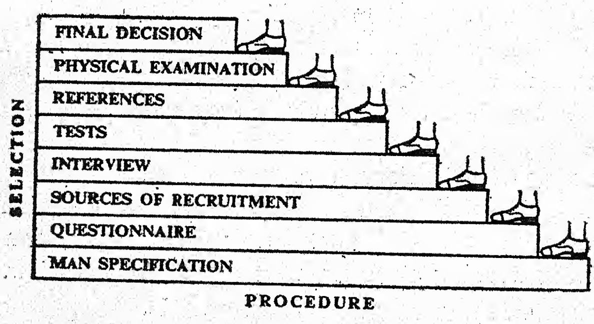
The first is very important, but is something overlooked. You must know what you want to do and where you want to go. The objectives may be long-range or short-term. Once the objectives are clearly defined in your mind, prepare a well thought out plan before you begin to execute it. Execution would involve adequate organising, delegating, staffing, motivating and communicating. It is necessary to evaluate the results which can well be even during the course of the year rather than at the end of it. Finally, it is necessary to make innovations or improvements and alter your objectives, where necessary.

The above are the five broad functions. The question of right personnel and their proper direction still remains important. In this connection there are certain major functions of a manager which come under the headings :

I SELECTION
II TRAINING
III CONTROL
IV REMUNERATION AND INCENTIVE

Selection has been purposely placed first. You must have the right raw material before you process it to get the final product. You have got to select wisely. In case you have to dismiss an employee, on a fair analysis, you can only arrive at one reason and one person to blame who is certainly not the employee involved. The fault lies in wrong selection. Had you selected wisely, trained appropriately and controlled effectively this dismissal would have become unnecessary. If you select the right type of person, it is easier to train and control him. Remuneration and incentives will then have a meaning.

The selection procedure means much more than an advertisement and an interview. The following are the steps in a scientific selection procedure:



It is best to prepare a "job analysis" and a "difficulty analysis" defining clearly the nature of the work involved. This will enable you to ascertain and list the qualities required of the person for executing that job effectively. Such a list is called a "Man Specification." Once the man specification is clearly defined, you will know the type of person for whom you are looking.

Questionnaire: The next step is to prepare a list of questions which the applicant is required to answer. This is known as the "questionnaire" or the "application blank." The questionnaire must be keyed to the man specification so that the answers would constitute an indication as to how far the applicant possesses the required qualities. The questionnaire is a very useful tool for weeding out undesirables. The next question would then be consideration of the sources of recruitment.

Sources of Recruitment: The question that arises here is—should recruitment be internal or external? Internal recruitment will encourage your staff. The staff will realise that, provided they work hard and prove their merit, promotion is available to them. The importing of new blood is only justified when you do not have a suitable person in your own organisation. Once the source of recruitment is fixed, applications received, weeding out over, next comes the interview.

Interview: Interviewing is an art. You may have heard that Hitler used a particular technique for interviews. He sat on a high pedestal in order to instil

awe into the minds of the persons to be interviewed and watched their reactions as they were made to walk up to him from a long corridor. This type of "scaring" interviews does not give satisfactory results. On the contrary, put the candidate at ease and tactfully get more information out of him which he would have otherwise withheld.

Then there are Psychological and Aptitude tests, which is a most controversial subject, followed by checking of references, medical examination and the final interview and decision.

You are now ready for training your employee. Many managers expect the new applicant to fit into the new job immediately without any assistance from his own organisation. Such managers are normally disappointed through no fault of the new entrant. It is your duty to train your employees. If they have a suitable general background or knowledge of office routine and commerce your training problem will be comparatively simple. As there are bound to be certain features peculiar to your own office the new entrant must be oriented into your environment and requirements.

Training Plan : In order to fix an adequate training plan it is necessary to answer the following questions :

I WHAT ?
II WHERE ?
III WHEN ?
IV BY WHOM ?
V HOW ?

With regard to "**what** is to be taught?" the job and the difficulty analyses would have laid the foundation for the kind of training required. The next question requires a decision as to whether training is to be centralised or decentralised. With regard to "**when** should training be given?" the answer would be, "In the beginning as well as continuously." Many offices do give initial training but overlook the importance of the fact that training must be continuous as there is room for improvement in all of us all the time. You would also have to decide "**by whom** should training be given?" that is, whether it is a line function and the superior is directly responsible, or whether it is a staff function to be performed by specialists in the organisation. The last question "how?" makes you think of and determine the training formula.

The Training Formula: An ideal training formula would be,

I PREPARE
II TELL
III SHOW
IV PRACTICE
V CHECK

In other words, **prepare** the candidate by making him want to be trained. Put him at ease in his new environment. Then **tell** him what is to be done and "why" it has to be done in a particular way. It is better to **show** him how it should be done. Now let him **practise.** You cannot teach a person to ride a horse by doing all the riding yourself. Let him make

mistakes. Encourage him to pull out of mistakes himself. It is not enough to train a person. His work should be **checked** every now and again. This should be done tactfully. The tactful technique is sometimes described as the **"Sandwich"** technique. Put your criticism politely in between two compliments. He will appreciate it the more.

Basic Training Methods: The three basic training methods are:

I TELLING
II SHOWING
III CONFERRING

In the first method, which is the orthodox method, you give the information. When time at your disposal is short it is the most effective and quickest method of transmitting information. Action speaks louder than words. Therefore, the showing method is more effective. The conferring or discussion technique is an effective method but is slow and time consuming.

Set a Good Example: The best mode of training,

Set a good example.

however, is by example. Control of the employees becomes easier as they are willing to follow the example set by the manager. Your employees are always watching you as to what you are doing.

The top man is like a gold fish in a bowl watched always by many. When you come to the office, come in time. Set a good example. The same is the case with the way you handle the inquiries. If you deal with specific inquiries by merely sending the catalogue, your subordinates, will follow your example and the company will suffer.

The Whip vs. The Carrot Technique : There are two techniques of control which may be described as (1) the "Whip" technique and (2) the "Carrot" technique. In the earlier days the "whip" technique was employed. If employees did not do a particular job, they were liable to be dismissed. There was always the threat of losing the job hanging over the heads.

Things have changed nowadays. The "whip" technique has become outmoded. Just as a donkey would move at the sight of a dangling carrot, employees can be moved by proper incentives and proper motivations.

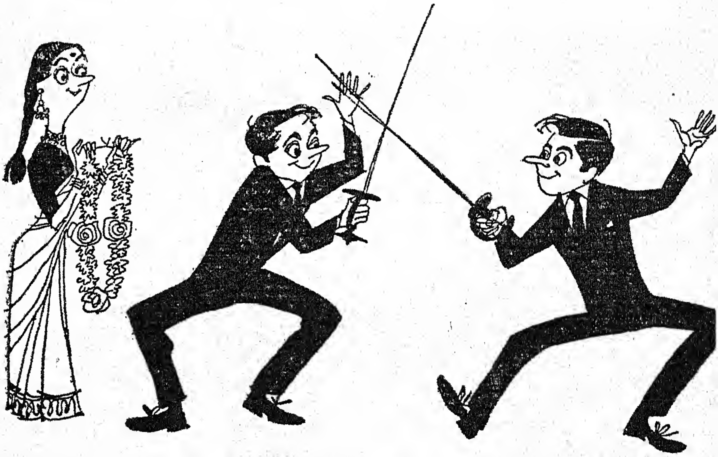
Delegation : Delegation is an important part of scientific management. Generally, in our country, delegation is missing. This may be due to various reasons. The manager may feel that subordinates cannot do things as well as he himself, but he must realise that unless he allows his subordinates to pick up greater part of his work, he will not be able to keep himself free for the more important duties. In order to build in your-

self this capacity to delegate, you must be willing to let go—willing to allow your subordinates to make mistakes, willing to trust them, and to give other peo-

The Carrot Technique.

ple's ideas a chance. As a manager, have your plan and then get things done through people and not try to do everything yourself.

The question of the carrot technique has already been discussed. The motivation or incentives can either be psychic or financial. It must be admitted that financial motivation is more effective than psychic.

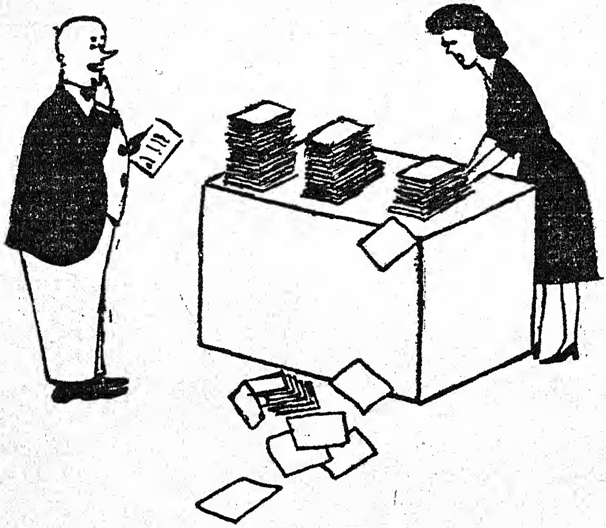


Motivation.

However, you know from personal experience, that if you pat a person on his back, he is happy. Praise him when praise is due. If he does something creditable, do not pat yourself on the back in front of your superiors. However, if you give him more money as bonus or prize he is happier. Both are important to keep up your staff's morale and motivate them to higher productivity.

II—MANAGEMENT OF MATERIALS & EQUIPMENT

We now come to the second aspect of how to run your office efficiently. This aspect will be more effective and easier if you have followed proper methods in the first, namely managing people.

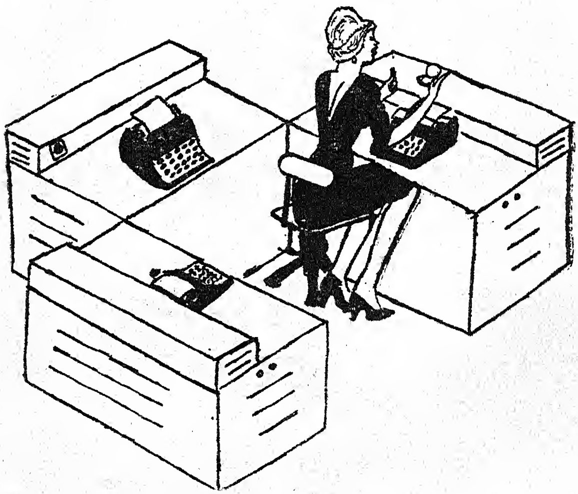


The Piling System.

Filing vs. Piling: One important aspect of efficient management of an office is the filing system. When we think of filing systems, we often think only in terms of storage, protection and attractiveness; but the most

important object has necessarily to be "finding". You must be able to lay your hands on the document or paper required. The filing system is, therefore, sometimes described as the system of "finding", instead of "filing". In poorly organised offices, there is "piling" instead of "filing".

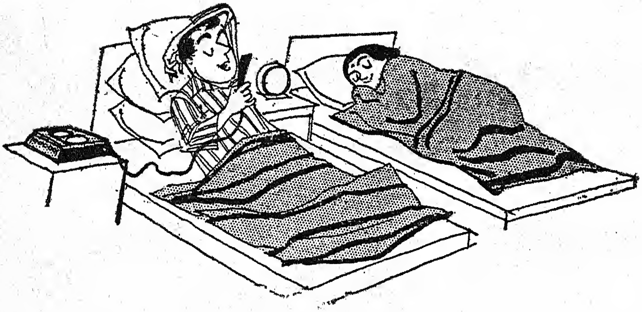
Equipment: Another important aspect is mechanical equipment. These may consist of automatic typewriters which have great utility where a number of circulars have to be sent individually typed.



Automatic Typewriters.

By using dictating machines, the problem of the stenographer can be solved to a large extent. The stenographer will not have to wait for your conveni-

ence and waste her time. Somehow, our executives are unable to get used to the idea of dictating machines, which definitely increase productivity.



Stenographer at home.

It is obvious that through scientific management, you as the manager can delegate all work of a routine nature. Follow the rule of management by exception. Deal only with out of the way type of work. You will then have more time for creative thinking resulting in innovations.

Every organisation must be progressive and not static. Innovation is the life-blood of progress.

Information Technology : Increased productivity is the result of improved techniques such as computers, automation, operation research, marketing research. From the point of view of running your office more efficiently, you are concerned with the control of data which may be described as information processing or

information technology. Information technology includes all tools and processes which help management to arrive at decisions by presenting relevant information.

Automation in the Office.

When I was in Australia recently, as a delegate from India to the CIOS International Congress on Scientific Management, I saw the electronic computer in action. It was rather stunning and frightening as it not only did card tricks, picked out information and telephone numbers from the telephone directory, but made one realise that management decisions and judgement in the future will be based on a mass of facts programmed into the machine and logically analysed by it more accurately than can be done by the human

mind. Decisions based on hunches will soon go into the past.

If you have an adequate system of management in your office, you can play a very effective role in the attainment by your organisation as a whole of its objectives by communicating and facilitating access to adequate information speedily.

6

As A Business Grows

N. H. Athreya

GROWTH certainly poses its problems, some of them very complex and confusing. Those who try to restrict their business for that reason—or for any other reason —should remember that a **business either grows or goes.** The writer knows a number of cases where the proprietor deliberately decided not to allow his business to expand. In the process, he did not allow the business to exist either. Though no formal study has yet been made in the country, over 80% of the "big' business today can be traced to "small" business of yesterday.

The growth can be quantitative or qualitative or both but growth is the very nature of every healthy business. Those who harp on small business would do well, therefore, to plead for and encourage business as such. In the final analysis, what we all seek

is what produces wealth for the country and it is enterprise that produces wealth: and it will be well if those in business and those in government do all that is in their power to encourage enterprise. Merely emphasising on the smallness of business will be fighting a natural phenomenon.

If the first phenomenon is that every healthy business grows, the second phenomenon today is that every healthy business is **growing in an accelerated way.** Many of us will like the growth to be much more leisurely but we are living and working in an accelerated, developmental economy and we have to face this phenomenon of accelerated growth. Growth in itself brings problems in its wake. Accelerated growth brings much more. If we care for the health of the business, we have to have **directed growth.** If growth just happens, there will be imbalance and lopsidedness and to that extent the future will be impaired. How do we direct growth, how do we direct orderly growth?

It is here that scientific management comes handy. I wish to confine myself to one of the major problems of a growing business: **the people-problem.** "The trouble with industry," said a one-time President of the International Harvester Co., "is that it is full of people." This is true. If there were no people, there will be no trouble. For that matter, there will be no industry either!

The people-problem has its roots in the expectations of the people concerned. And who are the people

concerned? The customers, the workforce, and the governmental personnel and general public.

Generally speaking, the expectations of the people in our country have changed since Independence and are constantly changing. As a business grows, the, expectancy of the people vis-a-vis the growing company changes in a big way.

The customers expect much more and much better service and unless the business takes up "marketing" and "innovation" as major and dynamic functions, the growth cannot be smooth or healthy. The scarcity economy today is likely to breed a false sense of complacency. For many years, the economic situation is not likely to serve us the warning and therein lurks the danger for a growing business.

A better service at a lesser cost, a better product at a lesser cost: that is normally ordered by the competitive situation. The absence of competent competition is likely to spoil the chances of healthy growth tomorrow and we have to warn ourselves constantly. Well-meaning business leaders should look ahead and take the initiative in their responsibility to the customer population.

As a business grows, the workforce and the general public modify their expectations. They expect the business leaders to behave as **trustees** instead of sole proprietors. 'Doing as one likes' is tolerated in a small-business proprietor, but not in a growing-business Director. And so does the Government. It expects much higher civic sense and social responsibility from

the manager and the owner of a business, as it grows. Demands are made more 'exacting'.

As a business grows, then, the situational demands change. Those who manage a business have to measure up to these changed demands if the going is to be good. The most significant section here is the Top Management. It has to concede the expectations of the people concerned and readjust its values and ways to suit the changed and changing demands of the population within and without. This is not easy. This does not happen. This readjustment has to be brought about consciously.

Middle management is the next important section. This section has less chances of sensing the changing demands of the situation. As a business grows, people therein do not grow automatically. They have to be grown. In fact, it is true to say that "companies grow as man grows and men should grow first." To make this growth possible is a responsibility of every Top Management.

When a company grows, it is important to remember the social environment in which it operates and to regulate its affairs according to what the public legitimately expect of the company. A growing business has to consciously win the goodwill of the public not only for itself—as it did when it was small—but for business as a system, as a way of life. The business leaders can ill afford to alienate the public by their thoughtless or short-sighted actions. They should constantly remember that the people can vote down

business as a system and in a democracy the power of the vote is the greatest power.

This raises the questions of business ethics and business morality. It is easy to argue that business need have nothing to do with morality, that all is fair in love and war. This attitude can prove treacherous in terms of the future of both **a** business and **the** business system as a whole. That perhaps is the reason why a leading industrial leader of America, H. W. Prentis, said:

> "It requires in particular that we so manage as to root our decisions and the actions of the enterprise we are responsible for in—
>
> "The principles of liberty, not the principles of compulsion;
>
> "The principles of reason, not the principles of force;
>
> "The principles of leadership by objective goals and by integration of voluntary efforts into co-operative teamwork, rather than leadership by command or fear;
>
> "The principles of morality, not the principles of materialism;
>
> "The principles of religion, not the principles of atheism;
>
> "And finally, the management and the business enterprise be rooted in the deep belief that however complex society and its social relationships may become, the natural rights of the individual

as a person, including the right to acquire and hold property, are of a different order of priority than the rights of Society."

He adds :

"Perhaps you are surprised that a hard-headed business man like myself defines management in terms of morality. Perhaps I trust not—you may say to yourself that these are the things one is expected to say in a speech, but they can be forgotten when one returns to his daily work. Let me, therefore, stress that it is precisely because I am a hard-headed business man that I lay the foundations of management on moral values. My working life has parallelled the great industrial revolution in the United States; it has parallelled the growth of my own company. Looking back on this past half century, I see above all that it is the moral values, the moral foundations, that are hard-headed and practical. Leadership on any other basis misleads and ruins."

MEETING THE CHALLENGE

As a business grows, we have to join hands with others in preserving business as a way of life, competitive enterprise as a way of life. Not because it means our perpetuation, but because it means higher standard of living for our countrymen.

The place of business in the common game of raising the standard of living and the problems of a growing business are not adequately understood by the

general public. We need set up a body akin to the Institute of Public Affairs in Australia to educate the public on the economic facts, on the place of competitive enterprise.

Many businesses have grown and are growing in a non-organised way. They would do well to set their houses in order well and quick. The time is opportune in that the economic pinch is no handicap now. It is an onerous responsibility; but discharging it will be richly rewarding.

7

Financial Control of Medium and Large Enterprises

N. N. Pai

AN enterprise or an undertaking can be classified as a medium or a large one, if it employs more than 100 workers and its investment in fixed assets amounts to not less than Rs. 10 lakhs. It is difficult to define clearly a medium-size undertaking.

Finance is the basis of the whole structure of the going concern and is the continuing concern of any Chief Executive. The resources at the disposal of those in charge of the enterprise are scarce and dear. It is, therefore, the responsibility of the top management for making the best use of the resources for optimum production and maximum profits. You cannot do much for shareholders, employees or customers if you do not make money. The fortunes of any enterprise, large, medium or small, to a great extent, depend

upon the financial control, which frequently receives the least attention from the top management until it is too late. According to Mr. T. G. Rose, a noted authority on finance, even where the business activity, the quality of the products marketed and the return on the capital employed are in the most satisfactory condition, it is possible for the enterprise to go into liquidation if the financial control has been unsound.

Financial Management and control involves the provision of adequate funds at all times for operating and capital purposes and the sound utilisation of these funds. An adequate organisational structure with authority delegated and duties clearly defined and people capable of performing their duties efficiently, honestly and with a spirit and attitude that will make for organisational cohesion, is the first requisite for financial control. The modern accounting system will include adequate internal checks and controls not only to safeguard the property and assets of the business but also to prevent errors and frauds. These, together with internal and statutory audit practices, provide normal control features in every well-managed enterprise.

Besides these ordinary measures, the data required for control of financial position are as under:

(1) **Monthly Balance Sheet:** A balance sheet is a statement of the assets, liabilities and net worth at a given date. It is the most important primary document of a business, since it shows whence the money in the business has been obtained and where it was

invested at the date the balance sheet was drawn. For the purpose of control, the important thing is not so much the actual position as the extent to which that position has changed since the end of the last financial year. Since horizontal form of balance sheet is not convenient for use in financial control, the same is prepared every month in vertical form and entered on a comparison sheet so that the movement of assets and liabilities since the beginning of the year can be watched.

(2) **Working capital statement:** One of the most vital points to watch in financial control is the liquid position which is usually checked by the ratio of current assets to current liabilities. Payments for goods and services must be made in cash and as such liquidity is an important factor in financial policy and is considered to be indicative of the financial stability of the enterprise. It reflects the extent of the working capital which is represented by the excess of current assets over current liabilities. Current assets are those which are in the form of cash or convertible into cash within a short period in the normal course of business. Examples are trade debtors, bills receivable, advances, stocks, work-in-progress, temporary investments etc. Current liabilities are those which have to be met within a short period and must be distinguished from long-term liabilities, such as debentures which is capital taken on loan usually for a long period at a fixed rate of interest.

It is generally considered that the ratio of current

assets to current liabilities of 2 : 1 is desirable, but there is no sanctity in such a ratio and this will vary with different industries. A business with a quick turnover needs much less working capital than another where the turnover is not so quick. A high current ratio may suggest non-utilization of resources. If a major portion of the current assets is made up of slow-moving inventories, work-in-progress and raw materials or accounts slow of collection, and the short-term liabilities have to be met promptly, the business may be approaching technical insolvency, even though it has a high current ratio. This happens when the enterprise is "overtrading". Since the only money received comes from the debtors, the cash coming in may not be adequate to cover current expenses. Unless, therefore, money can be borrowed, there is a grave danger that the enterprise may withhold payment of its creditors in order to pay the wages and expenses. This may end in the creditors putting the business into liquidation. It is, therefore, very important for an enterprise to examine the composition of the current assets. It is a good practice to watch the extent of the liquidity position by drawing up the statement each month, setting out first the current liabilities and then the current assets required to balance. Because of the undependable character of the current ratio, a more precise insight into the technical solvency can be had only by a further device to test the adequacy of the current ratio. This device is called the Liquid or the Acid Test Ratio and is obtained by comparing

the current assets exclusive of stocks and current liabilities less Bank overdrafts. The reason for the exclusion of Bank overdrafts is that it is a method of obtaining finance and bank accommodation is not necessarily liable to be paid on demand. Similarly, stocks are eliminated as these are not as quickly convertible into cash as debtors. A quick ratio of 1 : 1 is usually taken as a satisfactory index of business solvency.

Another useful and important information that could be obtained from the working capital statement is the ratio of Debtors to Creditors. The debtors represent the sale price of the goods sold, including the profit element, and as such provide cash to the enterprise for payment to the creditors for goods and services, whether for production or capital expenditure purposes. Therefore, it follows that normally the debtors of the enterprise should considerably exceed its creditors. The amount of this excess as a percentage depends upon the circumstances of the case and should be ascertained in each enterprise in order that a standard can be set up for checking purposes.

In an inflationary economy, large amounts get tied up in working capital, thus locking up funds vitally needed for purchase of machinery and plant. An analysis of working capital may indicate, amongst other things, that the stores and spare parts have continued to increase. Control over stores and spare parts is very vital, inasmuch as, apart from the risk of obsolescence, deterioration, damage, difficulty in storage etc., abundant stocks of stores and spare parts provide an indu-

cement to use them lavishly, resulting in wastage which can be avoided.

(3) **Operating profits:** The figure of operating profits is a further indication of financial efficiency which should be watched. It is of importance from the management standpoint, as indicating whether adequate use is being made of the total capital employed in the business. The theory of return on capital employed is a device by which profits can be measured by division, plant or commodities. This theory directs the management as to which direction to develop having regard to the comparative profitability of each division or department, and most important of all, it enables the management to judge, at a glance, whether the organisation is progressing or not. It also enables comparisons of the earning power of different industrial units within the same class.

The return on capital employed thus provides a standard measure of operating efficiency and the earning power of the business. It is the ratio of the net profits to the capital employed. The profits may be before or after tax. What return is to be expected from capital invested is a question that must be decided by taking into account the following factors:

1. Type of Industry
2. Location
3. Financial, political and fiscal factors
4. Risks involved etc.

The yield, however, should be fair. Abnormally high or abnormally low yield are both likely to be looked upon with suspicion.

There are differing views as to the computation of capital employed. It may be total assets employed in the business irrespective of their sources, while, it may be total assets exclusive of non-trading assets and outside liabilities. It may be that one enterprise adopts the value of fixed assets at original cost less depreciation, while some other may use estimated replacement costs. The computation of capital employed should be uniformly followed once a particular method is adopted.

The profit on capital employed must be sufficient to cover :

(1) Depreciation and increased cost of replacement of fixed assets,

(2) Amount to be retained into the business to provide for normal expansion and to provide against business fluctuations,

(3) Reasonable dividend after providing for taxation.

This theory of return on capital employed also enables the management to determine the question whether the enterprise could, in given circumstances, solely depend for sales on its own manufactured products or should resort to outside purchases. This point can be illustrated as under :

		Produce		Purchase
Sales	Rs.	10,00,000	Rs.	10,00,000
Profits after tax	Rs.	1,50,000	Rs.	1,25,000
Percentage to sales		15%		12.5%
Capital employed	Rs.	7,50,000	Rs.	5,00,000
Return on capital employed		20%		25%

This illustration indicates that though the cost of purchase would be higher, the capital employed would be lower to result in an improved return on capital employed by 5%. This would suggest that the producing of goods is not advantageous and the surplus capital can be utilised for other purposes.

(4) **The Cash Forecast** is another important factor in the financial control activity. Cash forecast is a must in the projection of money needs. The cash situation may be entirely different from the profit situation and many a concern which is making good profits in paper may be unable to meet its obligations as a result of bad financial management. Management can obtain information about the bills to be paid within the next three months and carefully estimate a cash forecast, setting out at the top the opening cash balance and the receipts during the month from Sales/ Debtors or from any other source of funds. The total will indicate the total cash available during the month.

Next come the cash outgoings beginning with the normal business payments for materials, wages, salaries etc., and capital expenditure which should be

shown separately. Payments to be made for dividends, interest on debentures, other loan capital, taxation and so on will be shown thereunder. The sum of these items will give the total cash required to meet all obligations during the month. Then by subtracting the estimated cash outgoings from the total cash available during the month, the management can find out whether there will be an increase or decrease of cash at the Bank or a decrease or increase of overdraft. The cash forecast should relate basically to established budgets and be flexible to reflect departures from budgeted performance. The three months' review is better than the single month ahead, because of the longer preview. A single month can show a big difference from forecast if a large cheque expected during the month is received in the first day or two of the subsequent month.

While on the subject of cash forecast, I would like to dwell briefly on budgets as an essential tool in the hands of management for control. Mr. Henry Fayol, a noted authority on Management, said: "to manage is to forecast and plan, to organise, to command, to co-ordinate and to control." A budget as a management tool will aptly fit in with this definition. In commonly accepted terminology, "it is a financial and/or quantitative statement prepared prior to a definite period of time, of the policy to be pursued during that period for the purpose of obtaining a given object." A budget will conform to Mr. Fayol's principles, because it forecasts and plans expenditure, income and activities

of the concern and the effect thereon of external influences, it organises the business to secure maximum profit from the fixed and working capitals available, coordinates the various departments in a well defined programme and helps the management in the delegation of responsibility and authority right down almost to the person who is actually responsible for production and spending. Budgetary control is a subject by itself and as such, I do not propose to go into details. I would only like to mention that, the budget should not be a watchdog, prying into the activities of executives. In short it should not be imposed but agreed. Budgets must begin from the shop floor sufficiently well in advance. A series of conferences at all management levels should be undertaken so that the discussions culminate in a series of operating budgets to fit well into the master plan. The operating budgets then become the standard which the executives must strive to reach. The targets themselves should be from the basis of past performance and from a statistical look into the future by study of trends and growth of business in one's own field.

Another important point with regard to budgeting is that it should be flexible. It should be capable of adjustment from time to time, for reasons beyond the company's control. Cases in point are the shrinkage or increase of market for the product through shifting consumer demand, entry of competitors into the field, economic conditions and price war, wage rates and cost of manufacture going high through rising prices and

Government legislation imposing new burdens for labour welfare, export and import tariffs etc.

In a fast expanding organisation, it is often necessary to provide long-term finance, because more investments become tied up irretrievably. The problems of a continuing and rising overdraft with the banks is not a solution because the function of bank overdraft is not for investment into assets at the cost of liquidity position. Alternatives of long-term financing by long-term borrowing and securing of equity capital have all to be studied.

There is the problem of capital expenditure in an expanding organisation which needs considerations of the general level of expenditure and the subsequent justification for individual projects within the programme. In planning capital expenditures, it is necessary to make a detailed study on the profitableness of each venture in case of an expansion or when it is replacement, how best it could be achieved. Capital expenditure budgets properly scheduled for each year and worked and properly recorded give much data as to the progress and investment of cash in fixed assets. Investments every month and year should be compared with programmed expenditures, so as to be able to plan the finance for consequent expenditure.

(5) **Statement of The Sources and Application of Funds:** The capital employed in a business is constantly changing and therefore, at reasonable intervals, say, a month, a statement of the Sources and Application of Funds should be prepared which will show

the alteration in the financial position between two dates. This statement is an important tool of financial control as it summarises changes in financial elements between two dates. The top management can watch from this statement how the money, with which it is doing business, is moving—whether during the month money has come into or gone out of the business.

The sources from which funds may be obtained by a business are as follows:

(a) Current profits
(b) Issue of new capital
(c) Long-term loans
(d) Sale of fixed assets or investments
(e) Amounts provided for depreciation or other reserves
(f) Decrease in working capital.

Funds may be applied for any of the following purposes:

(a) Losses incurred in the business
(b) Repayment of capital or long-term borrowings
(c) Payments of dividends to shareholders
(d) Purchase of fixed assets or investments
(e) Increase in working capital.

The method of preparation involves firstly a scrutiny of the Profit and Loss account to ascertain all debits (or credits) which are really transfers to (or from) reserves. These are added back to (or deducted from)

the profits as they are really appropriations of profits. Although depreciation is a very real charge against profits, it does not involve the use of cash resources and, therefore, adds to the financial resources of a business. Next a comparative balance sheet is prepared and the change in each item—whether plus or minus—is ascertained. These are then reflected in the funds statements. The current liabilities and current assets are reflected net by way of increase or decrease of working capital. Increase (or decrease) in other assets like fixed assets and investments or in other liabilities like capital reserves, long-term liabilities are all shown individually in the statement. This statement draws the attention of the top management to what has happened, perhaps more clearly than a financial statement would do.

(6) **Financial Ratios :** The financial efficiency of an enterprise is also assessed by means of ratios of one kind or another. Some of these ratios are of much assistance in financial control.

(a) **Liquid Assets to Current Liabilities :** This ratio is known as the liquid ratio or Acid Test Ratio and indicates, as explained earlier, the adequacy (or otherwise) of the cash resources of the business to meet immediate current commitments. Where the ratio is less than one, the position should be examined to see if some of the current assets can be turned into liquid assets or alternatively if it is possible to reduce the current liabilities.

(b) **Current Assets to Current Liabilities :** This ratio

known as the current ratio, is a test of solvency or short term financial strength, as explained earlier.

(c) **Turnover of Debtors :** This ratio indicates the number of days the credit is outstanding at the balance sheet date. It measures the capital locked up in book debts and the efficiency of credit control. The amount of credit sales for the year is divided by 365 to give the average daily sales by which the receivables outstanding at the end of the year is divided and the result is the number of days' credit outstanding at the balance sheet date. If the length of time revealed is excessive compared with the average period of credit allowed, it indicates the inefficiency of the Collection Department.

(d) **Stock-turnover :** This is another important ratio measuring the operating efficiency of the business and is ascertained by dividing the cost of goods sold by the average of the inventories. The rapidity of the turnover itself varies considerably according to the class of the business. For example, the rate of stock turnover would be much higher in a concern dealing with, say food, as compared with those dealing with motor cars. In the case of a manufacturing concern, the rate of turnover should be calculated separately for raw materials and finished goods. A low stock turnover may be the result of bad buying, accumulation of obsolete stock or carrying of too much stock. This is a danger signal. When the stock turnover is quick, the company can afford to sell on a smaller gross profit margin.

(e) **Ratio of sales to fixed assets or Plant turnover :** By comparison of the ratio from year to year or with competitors' ratios, the management can get a rough idea of how well the fixed investment is being used. A high ratio indicates low fixed charges. Businesses with a low ratio should provide themselves with sufficient safeguard to ward off trouble during a period of depression and business recession.

(f) **Operating profits to total capital employed :** This is the ratio of operating profit (before or after taxes) to total capital employed (excluding non-operating assets), and indicates the economic productivity of capital and the earning power of the business. This ratio, therefore, embraces all the investment activities of the management.

(g) **Net profit to net worth :** This ratio indicates the earning power of the invested capital and will show what shareholders will receive after taxation charges have been met, and how well the funds invested in the business has been utilised.

Ratios, however, suffer from the disadvantage that when they change, it is not possible to say without reference to the figures themselves whether the movement has been influenced by one or the other, or both. They are clues rather than conclusions. They explain and emphasise and only indicate the direction in which further enquiries should be made. For example, the trading losses of an enterprise may be due to its excessive labour cost. Ratio analysis will indicate the weakness but will not give the reasons for the trouble

which will have to be determined by further investigation. In spite of these limitations, the Ratio analysis is of the greatest significance in regulating the operational efficiency of an enterprise, as they give immense amount of information and provide :

(i) measures by which to gauge the result of past operations,

(ii) guides by which to regulate the present performance and

(iii) goals by which to set future estimates.

8

Financial Control of Small Enterprises

M. R. Shroff

A SMALL enterprise is generally understood today as one having an investment in fixed assets not exceeding Rs. 5 lakhs, irrespective of the number of workers.

The typical small enterprise is financed by the **owner-manager,** his **family** and **friends.** The constitution may take the form of a sole proprietorship, a partnership, or a joint-stock company. It has virtually no access to the stock market and thus there is an obvious limitation on the amount of capital that can be raised. Besides, there is very often a strong desire on the part of the owners to retain controlling interest in the business which restricts the amount of outside capital coming in.

Ploughing back of profits also presents formidable

difficulties owing to relatively low profitability, as compared to large enterprises, and high rate of taxation. Even where the enterprise takes a corporate form, it usually comes under the mischief of Section 23A of the Income-Tax Act which entails a compulsory distribution of a certain percentage of the profits as dividends.

The scope for raising loans and debentures is restricted owing to the limited availability of tangible assets which can be offered as security. Even where unsecured loans can be raised, the rate of interest payable would be relatively high.

Fortunately, in recent years a number of agencies catering to the needs of small business have come on the scene, which may be mentioned here.

(i) The State Bank of India has a liberalised scheme for granting Short-term loans for working capital requirements, normally against hypothecation of stocks, and in appropriate cases even as clean advances. Usually accommodation is extended to units whose products have an assured market, e.g., goods manufactured against Government or other firm orders or in cases where they are readily saleable. Where the security offered is inadequate, a collateral in the form of a mortgage on immovable property may be insisted on and/or guarantees from third parties.

(ii) Other Commercial Banks also grant short-term loans to small enterprises. As a rule, these Banks have not contributed in any substantial

manner to the financing of small enterprises in view of the rigid standards applied for screening loan applications.

(iii) **State Finance Corporations :**

(a) These Corporations mainly extend medium and long-term loans for meeting requirements of industrial concerns, which are not ordinarily met by commercial banks. The loans are usually given against security of fixed assets keeping a minimum margin of 50%.

(b) These Corporations often also act as agents of the State Governments under the State Aid to Industries Rules, under which loan applications within prescribed limits for new as well as existing enterprises are entertained.

(iv) **National Small Industries Corporation Pvt. Ltd.**

The Corporation supplies plant and machinery to small-scale industries on hire-purchase terms, spread over 5 to 7 years, retaining an earnest money deposit.

These agencies put together meet hardly 40% of the estimated need of small industries. The balance has to be met through non-institutional channels like the Shroffs and Multanis at much higher rates of interest.

The time taken for scrutiny of applications by these institutions is in many cases very long and trying.

Besides, the standards of safety governing the advances and the capacity of the party to provide the prescribed margins are set at a level which small businesses are often unable to comply. What somebody said of a Bank, "A place where they lend you an umbrella in fair weather and ask for it back again when it begins to rain", may well apply to these institutions.

The need for husbanding to the maximum extent possible the available financial resources, therefore, becomes imperative in the light of above-referred handicaps.

Adequate financial control is necessary for all businesses, big or small. The extent to which detailed control is necessary and desirable will depend upon the size and type of business.

There are two major purposes for which accounting records are normally considered essential: (a) Tax purposes, and (b) Management purposes. However, there is also a third purpose which is not often realised, viz., the need for detailed information required for procuring financial accommodation in whatever form.

As a matter of fact, in a fast developing economy like ours, there is hardly any enterprise today which does not require additional funds for its growth. The advisability of adequate information being made available for this purpose even in the case of small enterprises cannot be over-emphasised, especially as the lack of it has often been advanced as one of the main reasons for the delay in scrutinising loan applications by most of the financing agencies.

The following tools may be considered necessary for effective financial control of small enterprises :—

(a) Budgetary Control Statements,
(b) Cost Statements
(c) Capital Expenditure Statements
(d) Statement of what is owned and what is owed

(a) Budgetary Control

This essentially comprises of setting targets for various areas of the enterprise's activity, e.g. sales, production, cash, profit or loss etc., and the periodical comparison of actuals with the budgeted figures to determine the departures, if any, from the planned targets. As much attention should be paid to positive variances, which are really areas of improvement, as to negative ones. Though highly desirable for any business, budgetary control should be introduced gradually starting with only one or two areas of management.

Being confined to the subject of Financial Control, a word of caution may be mentioned in the preparation of a "Cash Budget". The net cash deficit or surplus, as the case may be, arising should be computed monthly or quarterly. Figures ascertained for a period of a year and then averaged over a month or a quarter could be quite deceptive as the peak requirements of a business could well be far in excess of the average.

Besides, high protfiability should not be confused with high liquidity. Not seldom does a business find itself in an unenviable position where despite adequate pro-

fits flowing in the cash position becomes unsatisfactory, especially during a period of rapid growth. This could well be if the outgo on acquisition of fixed and or current assets as also reduction of liabilities is in excess of additional capital, loans and profit **plus** non-cash expenditure like depreciation. The reverse phenomenon of increasing liquidity, albeit short-lived, with declining profits or even while making losses, consequent to a recession in sales, may also be found to operate.

Budgetary Control offers an excellent opportunity for proper delegation of responsibilities and thus assists in building up a sound organisational structure.

(b) Cost Control

A small enterprise working on low margins is in a vulnerable position and has to keep a close watch on the cost of its products A system of standard costing, wherein costs are determined prior to production or supply, should be preferred to historical costing which amounts to **post mortem** and is of little help to management.

Standard costs considerably assist management in quoting for forward orders as prices based thereon have a rational relationship of costs and would not merely be based on the principle of "what the traffic can bear". Besides, it is also an effective tool in making a "make or buy" decision.

(c) Capital Expenditure Control

Financial planning should essentially commence at

the very stage when a business proposal is conceived, but this is seldom done. This will ensure that the enterprise does not become financially shaky from the start, especially when resources are limited as in a small business. The proportion in which available capital is going to be distributed between fixed and current assets should be judiciously worked out. Amount spent on acquisition of fixed assets is tantamount to withdrawal of cash from circulation in the business, which only trickles back into the main cash flow stream through depreciation provisions, thus impairing liquidity. Within the fixed asset block also care should be exercised in expending as little as possible on land and buildings, these being normally the least productive assets.

(d) Statement of what is owned and what is owed :

The net worth of the business which is the excess of tangible assets over liabilities is an important figure to be constantly kept in view. Besides circulating assets, e.g., stocks, debtors and cash, require constant watching in respect of the relation they bear to sales as also to current liabilities. It is not seldom that a small business is called upon to extend liberal credit facilities to its clients which are not necessarily reciprocated by its suppliers. The impact of this on cash balances must be carefully worked out.

Good times like the present, when practically anything sells owing to the general buoyance in the economy, can be **perilous.** It breeds a sense of com-

placency, which can be particularly fatal to a small business in the event of an adverse turn in the terms of trade. Nevertheless, this offers the right opportunity for instituting financial controls, when the business is not unduly exposed to the vicissitudes of trade.

Small enterprises are playing an ever increasing role in even the most highly industrialised countries of the world, e.g., U.S.A., Germany, U.K., and Japan. The importance of these units in India's economy is bound to grow with the years and it is, therefore, imperative that sound foundations are laid from now.

Many an industrial edifice we see today started as a small enterprise and undoubtedly quite a few of these units set up in recent years may well rank among the important large-scale enterprises of tomorrow. Sound financial management is one of the essential pre-requisites for ensuring this growth. It was rightly said, "Bad production management and bad sales management have slain their thousands, but faulty finance has slain its tens of thousands". (Collin Brooks).

9

Human Relations in Industry

Dr. S. K. Parukh

THERE are four major areas covered by human relations in industry. The first of these can be described as the measurement area (psychometry and sociometry). Here the specialists tell us something about how to measure the potential and actual abilities of employees, how to prepare personality profiles, how to describe a working group in action, etc.

The second area deals with problems of training and developing men in business and industrial organisations. The training specialists give us principles and techniques of effective and rapid training. They tell us how to get knowledge transmitted into skill, how to teach so as to facilitate maximum understanding and retention of what is taught, etc.

Yet another area pertaining to human relations in industry can be described as human engineering. The

human engineering experts tell us how to design machines to suit men, what effect have temperature, ventilation, noise, etc., on employee performance, etc.

The fourth area is the most important one and one where, as laymen in industry, we have the maximum opportunity to experiment with. This area is related to problems of changing attitude, and resolving problems and is referred to as the "dynamic" area.

There are more than one reasons why, as laymen, we should be interested in this area. First of all, supervisors or managers are seldom called upon to exercise psychometric, training, or human engineering skills. Yet almost all of us are repeatedly confronted with problems of how to resolve conflicts and frustration, how to build morale or the will to work, how to engender the spirit of co-operation, how to meet that diabolical need or self-assertion so characteristic of our age. The dynamic area in human relations deals with these problems. In other words, it deals with a variety of human relations skills.

The first of these skills is related to the ability to communicate. We need to communicate all the time in industry. Unfortunately, the emphasis has been more on the content and channels of communication rather than on the process of communication. In modern industry we have multiplied a variety of written and oral channels of communication to enable top management policies to filter down to employees. What we have not considered, however, is whether these channels function effectively. One important area

where it should function is face-to-face communication, whether it takes place between a superior and his subordinate or between one colleague and another.

What is communication in face-to-face relationship? It implies looking, listening and talking. The purpose is to perceive one another in action. In order that this perception be realistic, we must see that what we partly perceive is not identified with the whole man. For example, in a selection interview, we notice a tendency to judge an interviewee in terms of his part perception by us. If, for instance, I do not like the colour of his tie, or the way he fidgets with his hands, this perception may condition my entire valuation of the interviewee.

Again, in face-to face communication, we use words which are often emotional. This emotional content conditions our perception of men. For instance, if we call a person "bania" the very use of that word puts us in a certain frame of mind in communicating with him.

Thirdly, we tend to identify an individual—an ever-changing entity—with a label which is always static, unchanging. For instance, I may label a new salesman "inefficient". After being exposed to the market over a period of time he changes. Yet most of my reactions to him are likely to be governed by the initial label.

Communication involves not merely talking, but listening also. In fact, listening is a very important and an extraordinarily difficult aspect of communication.

We often find that as we are listening to someone, we are manufacturing counter arguments in our own minds to come out with the moment he stops talking. Listening requires a certain amount of quiet attention and most of us are incapable of it. If we watch our mind when someone is talking, we find that it is chattering all the time. This pre-occupation with itself does not permit the mind to be receptive enough to what is being said by another.

Again, when one listens attentively, one takes in not only what is being said, but also what is not said but implied by the speaker. In other words listening, to be effective, must be done in between the words in the same way as one reads in between the lines.

The second facet to human relations skill in industry is related to helping people resolve problems. This is an important skill which one is called upon to exercise frequently. The higher one is on the supervisory or managerial ladder, the more frequently is he called upon to help people solve problems. The issue here is not one of giving the right answer. An individual in trouble may know all about his problem, such as the problem of frustration for not being promoted. He, therefore, does not need more **information** about the problem. The skill one has to exercise is in terms of helping him resolve his problem; in other words, be free from it. Research indicates that we could throw a man on his own so that he can face his own problems without passing judgement about it, in other words, without resorting to defences or escapes there

arises the possibility of freedom from the problem. One facilitates this extensive perception by creating a social climate of non-judgemental acceptance of the man as he is. This kind of social acceptance is not something that a professional psychologist could alone exercise. Any intelligent man can do so. We often find a youngster talking about his problems to a friend rather than to his teacher, knowing that the latter would instinctively take a judgemental reaction towards him.

The third kind of skill that we may be called upon to excercise is leadership skill. Democratic leadership, whether practised in educational institutions or in industrial organisations, facilitates productivity and human satisfaction! There are, however, certain misconceptions about leadership. One of these is that the leader has something in him which he can give to the follower. No doubt in industry this is true in certain areas. For instance, a leader in a concern could give effective administrative procedures and policies to his subordinates. What he cannot give is creativity, self-confidence and maturity. If any one attempts to do this, he is not developing people but encouraging imitators. What one can do as a democratic leader is to be aware of his own reactions and see to what extent they interfere with the natural growth and development of the individual one is supposed to lead. The very philosophy behind democratic leadership is that although people are of different capacities, they all have one thing in common, viz., the ability to grow and unfold

as human beings. Capabilities no doubt differ. One may be able to paint, another may not be able to do so. This should not, however, lead to a psychological hierarchy. In this light, the leader must understand that leadership is not a status, but a function. If he understands this, he will also perceive that all prerogatives that go with leadership, the air-conditioned cabin, a big table, etc., really go with the functions performed by him and one not attached to his person as a leader. So long as we do not get an appreciation of the concept of leadership in industry, there will be discontentment, jealousy and suspicion of each other.

We have seen three areas where a man can exercise skills in human relations. The crux of this skill is the ability to create a climate of non-judgemental acceptance in which each individual can face his own problems and realise that the only way he can resolve them is for and by himself. This leads us to another important point. In order to exercise adequately the human relations skill—the ability to communicate, the ability to help people resolve problems and the ability to lead them so as to facilitate their maximum growth—it is necessary to understand one's own psychological process. It is necessary, for instance, to become deeply conscious whenever dealing with people of one's own basic motives and intentions. If I pretend that I am diplomatic with my boss, when I am really frightened of him, it would indicate a lack of awareness of my own deeper intentions. Many of our actions are done without understanding the deeper motives behind them.

Unless one can become aware of oneself in action, one cannot fully become aware of another. A person who is sensitive to his own drives and tendencies develops sensitivity in inter personnel relationship without which he cannot work effectively and harmoniously with people.

A sensitive man is not one who has merely an intellectual appreciation of what he does. No doubt his mind must grasp the meaning of sensitivity, but what is more important is that he must **feel** sensitive. Understanding sensitivity in this way implies a fusion of the mind, heart and the nervous system. Without this fusion or intergrity within oneself, there cannot be enlightened relationship with another. This sensitivity is the beginning of good human relationship.

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Appendix A

Bibliography

The authors suggest the following books and reports for those who are interested to make a further study of the subject :—

HOW TO START AN INDUSTRY

1. Reports of the Ministry of Commerce & Industry, Government of India.
2. Parliamentary Estimates Committee Reports.
3. National Small-Scale Industries Corporation Reports.

COMPANY TAXATION

1. **The Law & Practice of Income Tax**—J. B. Kanga & N. A. Palkhivala
2. **Taxation & Foreign Investment**—National Council of Applied Economic Research
3. **The Income Tax Digest**—A. N. Aiyar

4. **The Indian Income Tax Act, 1922**—A. N. Aiyar, S. V. Aiyar and T. A. Rajgopal
5. **The Finance Act, 1959.**
6. **The Finance Act, 1960**
7. **The Finance Act, 1961**

COMPANY LAW

1. **Guide to Companies Act**—A. Ramaiya (Pub: Madras Law Journal)
2. **Companies' Act 1956**—A. N. Aiyar (Pub: Company Law Institute of India, Madras-17).

MARKETING AND ADVERTISING

1. **Modern Marketing**—Harry Walker Hebner (McGraw Hill)
2. **Modern Marketing Management and Integrated Approach**—Ferdinand F. Mausee (McGraw Hill)
3. **Advertising—Case Material** (Richard Irwin)
4. **Practical Salesmanship**—R. S. Davar (Progressive Corporation Pvt. Ltd.)

HOW TO RUN YOUR OFFICE MORE EFFICIENTLY

1. **Davar's Business Organisation, Industrial Organisation & Secretarial Practice.**

2. **Text Book of Office Management**—Leffingwell & Robinson
3. **Design and Control of Business Forms**—Knox

AS A BUSINESS GROWS

1. **The Elements of Administration**—L. Urwick (Pub: Pitman)
2. **Industrial and General Management**—Henri Fayol (Pub: Pitman)
3. **Freedom and Co-ordination**—M. P. Follett (Pub: Management Publications Trust Ltd. London)
4. **The Functions of the Executive**—C. I. Barnard
5. **Organisation: The Framework of Management**—E. F. L. Brech
6. **The Practice of Management**—P. F. Drucker (Pub : William Heinemann Ltd. London)
7. **Higher Management Control**—T. G. Rose & D. E. Farr
8. **Classics in Management**—(Selections) (Pub: American Management Association)
9. **Technique of Executive Control**—E. H. Schell (McGraw Hill)
10. **Managerial Economics**—Joel Dean **(Pub: Prentice** Hall, Inc.)
11. **Principles of Management**—H. Koontz & C. O'Donnell
12. **Administrative Action**—W. H. Newman (Pub: Prentice-Hall, Inc.)

FINANCIAL CONTROL OF MEDIUM AND LARGE ENTERPRISES

1. **Top Management Handbook**—edited by H. B. Maynard (McGraw Hill)
2. **Financial & Administrative Accounting**—Smith & Ashburne (Pub.: as above)
3. **Higher Control in Managment**—T. G. Rose
4. **The Internal Finance of Industrial Undertakings** —T. G. Rose
5. **Controllership**—Heckert & Wilson (Ronald Press)
6. **Budgetary Control**—H. P. Court

FINANCIAL CONTROL OF SMALL ENTERPRISES

1. **Management Accounting for Profit Control**—Keller (McGraw Hill Publication)
2. **Budgetary Control and Standard Costs**—Scott (Pitman Publication)
3. **Cost Accountant**—Journal of the Institute of Cost and Works Accountants.

HUMAN RELATIONS IN INDUSTRY

1. **The New Psychology for Leadership Based on Researches in Group Dynamics & Human Relations.**—Laird, Donald, A & Eleanor C. McGraw Hill.

2. **Language in Thought & Action**—Hayakawa, IS. I (Harper Bros.)
3. **Personnel Administration—A Point of View and a Method**—Pigors, Paul & Myers, Charles A (McGraw-Hill)
4. **The Whole Man Goes to Work**—Nunn, Henry L (Harper Bross.)
5. **Motivation & Morals in Industry**—Viteless, Morris S. (W. W. Norton & Co.)